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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

ALBERT K. BROWN; CATHERINE D. BROWN; KENT ROSENBERG; ARLENE ROSENBERG; VICTOR SCHULER; ELIZABETH SCHULER; DONALD E. WOOD; ELLEN L. WOOD; AMERICAN NATIONAL BANK, a State Banking Corporation, Trustee under the EARL HILLIARD TRUST; MARGARET HILLIARD; JEROME A. RAY; KAREN M. RAY and KENNETH R. HILLIARD
Petitioners

v

SHELL OIL COMPANY, a Delaware Corporation,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE STATE OF MICHIGAN COURT OF APPEALS

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QUESTION PRESENTED FOR REVIEW

Petitioners brought suit in the Michigan Circuit Court for Grand Traverse County against Shell Oil Company contending that Shell had improperly charged them with a share of the Michigan severance tax, a specific tax levied upon all producers engaged in the business of severing oil and gas from the soil. Petitioners contended that, as owners of mineral interests who had simply leased their interests to Shell, they were not engaged in the business of severing oil and gas and therefore were not obligated to bear any portion of the tax.

The Circuit Court granted Shell summary judgment, holding that, as owners of mineral interests leased to Shell, Petitioners as a matter of law are producers engaged in the business of severing oil and gas and, therefore, are bound to bear a portion of the severance tax. Claiming error, Petitioners appealed that decision to the Michigan Court of Appeals, citing cases from other jurisdictions which had held that mineral owners as a matter of fact are not engaged in the business of severing or producing oil and gas, and cases that had held as unconstitutional legislation which had attempted by definition to include mineral owners as producers, because legislatures do not have the power to impose business, occupation or privilege taxes on persons in fact not engaged in the business or occupation taxed, or possessed of the taxed privilege.

Using forced construction, the Michigan Court of Appeals surprisingly found that, irrespective of the plain words of the statute levying the tax on producers engaged in the business of severing, the Michigan severance tax was not a business, occupation or privilege tax, thereby skirting the constitutional problems existing in the cases cited to it by Petitioners. Applications for Rehearing and Application for Leave to Appeal to the Michigan Supreme Court have been denied.

Have the Michigan Courts violated Petitioners' 14th Amendment Due Process rights by interpreting the Michi-

gan severance tax statute, which, on its face, imposes a "specific tax" on "producers engaged in the business of severing oil or gas from the soil" as levying a tax "not in the nature of a business, licensing, privilege or occupational tax," and on that basis concluding that a share of that tax is properly imposed upon Petitioners, owners of minerals leased to Respondent Shell Oil Company, when in fact Petitioners are neither engaged in the business of production, nor engaged in the business of severing oil or gas from the soil, and, thereafter, denying Petitioners the opportunity to challenge that interpretation and conclusion?

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ALBERT K. BROWN; CATHERINE D. BROWN; KENT ROSENBERG; ARLENE ROSENBERG; VICTOR SCHULER; ELIZABETH SCHULER; DONALD E. WOOD; ELLEN L. WOOD; AMERICAN NATIONAL BANK, a State Banking Corporation, Trustee under the EARL HILLIARD TRUST; MARGARET HILLIARD; JEROME A. RAY; KAREN M. RAY and KENNETH R. HILLIARD — *Petitioners*

V

SHELL OIL COMPANY, a Delaware Corporation, *Respondent.*

PETITION FOR WRIT OF CERTIORARI
TO THE STATE OF MICHIGAN COURT OF APPEALS

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States.

Albert K. Brown, et at, Petitioners herein, pray that a WRIT OF CERTIORARI issue to review the Judgment of the Michigan Court of Appeals entered in the above-entitled case on August 16, 1983. Pursuant to Sup. Ct. R. 28.4, notice is given that 28 USC 2403(b) may be applicable.

QUESTION PRESENTED FOR REVIEW

Petitioners brought suit in the Michigan Circuit Court for Grand Traverse County against Shell Oil Company contending that Shell had improperly charged them with a share of the Michigan severance tax, a specific tax levied upon all producers engaged in the business of severing oil and gas from the soil. Petitioners contended that, as owners of mineral interests who had simply leased their interests to Shell, they were not engaged in the business of severing oil and

gas and therefore were not obligated to bear any portion of the tax.

The Circuit Court granted Shell summary judgment, holding that, as owners of mineral interests leased to Shell, Petitioners as a matter of law are producers engaged in the business of severing oil and gas and, therefore, are bound to bear a portion of the severance tax. Claiming error, Petitioners appealed that decision to the Michigan Court of Appeals, citing cases from other jurisdictions which had held that mineral owners as a matter of fact are not engaged in the business of severing or producing oil and gas, and cases that had held as unconstitutional legislation which had attempted by definition to include mineral owners as producers, because legislatures do not have the power to impose business, occupation or privilege taxes on persons in fact not engaged in the business or occupation taxed, or possessed of the taxed privilege.

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Have the Michigan Courts violated Petitioners' 14th Amendment Due Process rights by interpreting the Michigan severance tax statute, which, on its face, imposes a "specific tax" on "producers engaged in the business of severing oil or gas from the soil" as levying a tax "not in the nature of a business, licensing, privilege or occupational tax," and on that basis concluding that a share of that tax is properly imposed upon Petitioners, owners of minerals leased to Respondent Shell Oil Company, when in fact Petitioners are neither engaged in the business of production, nor engaged in the business of severing oil or gas from the soil, and, thereafter, denying Petitioners the opportunity to challenge that interpretation and conclusion?

PARTIES TO THE PROCEEDING

In addition to the persons identified in the caption, 108 others have been permitted to intervene as parties plaintiffs.[1] Respondent is as named in the caption.

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[1] Estate of Jo Hannah H. Hilliard; Ernest C. Hilliard; Betty L. Hilliard; Carolyn M. Webber; Eli Hilliard; Margaret L. Hilliard; George Lewis; Sonja Sue Lewis; Matt Kolb; Bertha T. Kolb; Francis Latuszek; Mary J. Latuszek; James F. Lawnichak; Roberta H. Lawnichak; Charles V. House; Maryetta J. House; Ivan H. Eckler, as survivor of himself and Martina F. Eckler, deceased; Walter B. Campbell; Leona Campbell; Anthony Myszkier; Johanna Myszkier; Dale W. Fox; Ina Jean Fox; Ronald R. Wood; Janet K. Wood; Willard Brown; Sharon Brown; Leah P. Welch; Lila Mae Keskine; Arthur Maski; Waive Maski; Mose D. Weber; Melvena L. Weber; Jerome Marcenkowski; Irene Marcenkowski; 1st National Bank of Petoskey, Trustee under the Stanley and Helen Styles Trust; Arthur Matusiak; Robert J. Van Dellen; Ann Bickley Van Dellen; Chester Van Dellen, Jr.; Judy Ann Van Dellen; Chester Van Dellen, Jr. and Robert J. Van Dellen, Co-Trustees under the Anne Van Dellen Trust; Ann Van Dellen, Guardian of the Estate of Chester Van Dellen, M.I.; C. Van Dellen Oil Company, Chester Van Dellen, Jr., General Partner; Larry Luther; Lenora Luther; Dixie Lillian Merrithew; Joel D. Meister; Ellis Meister; Timothy Hillegonds and Old Kent Bank & Trust Company, Trustees under the Russell Klaasen Trust; William Fisher; Hugh D. Bowling; Kathleen F. Bowling; Hugh D. Bowling and Kathleen F. Bowling; Patrice Freel; Michael Freel; Donald Meister; Gerald Meister; Virginia Koskela; Delbert Meister; William J. Strickler; Archie Black, Trustee of the Archie Black Trust; Comerica Bank — Detroit, Maxine Koscielniak and Jean Cooley, Co-Successor Trustees of the Mary Black Trust; Raymond Cooley; Bruno C. Muzyl; Ina Jean Fox, Personal Representative of the Estate of Robert B. Campbell; Stanley S. Styles and Gregory D. Styles; Trustees under the Douglas Styles Trust; Stanley S. Styles and Gregory D. Styles, Trustees under the Dyann M. Otero Trust; Stanley S. Styles; Jane Galvin; Gregory D. Styles, d/b/a Stangor Land Company; Empire National Bank, Trustee under the Norine E. Weber Trust; Craig H. Curtiss; Beverly A. Curtiss; Craig H. Curtiss and Beverly A. Curtiss; Craig H. Curtiss, d/b/a C. H. Curtiss & Associates; Old Kent Bank & Trust Company, Trustee under the Vera Veraghen Trust; Old Kent Bank & Trust Company, Trustee under the Martin Veraghen Trust; Detroit Bank & Trust Company (Comerica Bank), Trustee under the Raymond Butka Trust; Richard Schneider, d/b/a Sandy & Company; Vern M. Jones; Ann T. Jones; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Kolen Ackerman Family Mineral Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Roy A. Bancroft Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the

(Footnote continued on next page)

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Howard Z. Bisard Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Clous Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the F.nk Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Leeta M. Fudge Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Bertha C. Heaton Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Marshall L. Hoffman Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Dee N. Jefferson Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Gary D. Jefferson Irrevocable Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Morgan Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Ralph Joseph Ockert Revocable Inter Vivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Elenora A. Pulaski Irrevocable Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Rawlings Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Irma R. Rosenberg Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Rudolph A. Sedlacek and Vesta A. Sedlacek Irrevocable Inter Vivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Peter P. Sedlar Revocable Intervivos Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Peter Sedlar Marital Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Ann E. Sedlar Revocable Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Svec Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the (Leonard B.) Taylor Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Raymond G. Taylor Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Waslawski Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Ireta Leora Weidenhamer Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Barbara Usher Windrim Revocable Intervivos Trust Agreement; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Wurm Family Trust; Pacesetter Bank and Trust, Grand Traverse, a State Banking Corporation, Trustee under the Pierce Stocking Trust.

OPINIONS BELOW:

The Opinion of the Michigan Court of Appeals was reported at 128 Mich. App. 111, 339 N.W.2d 709 (1983) and is printed in Appendix A hereto, *infra* at Page A-2. The Judgment of the Grand Traverse County Circuit Court dated April 6, 1982, and affirmed by the Michigan Court of Appeals is printed in Appendix A, *infra* at Page A-11, together with an excerpt of the transcript of the Circuit Court's remarks, (Appendix A, *infra* at Page A-13).

JURISDICTIONAL STATEMENT

The Judgment of the Michigan Court of Appeals was entered August 16, 1983, (Appendix A, *infra* Page A-2). A timely Petition for Rehearing was denied on November 4, 1983, (Appendix A, *infra* Page A-24). A timely Application for Leave to Appeal the Decision was filed with the Michigan Supreme Court (Appendix C, *infra* Page C-39), with supplements filed on October 5, 1984, (Appendix C, *infra* Page C-83), and on March 29, 1985, (Appendix C, *infra* Page C-87). On June 22, 1984, by Order of the Court, the Application for Leave to Appeal was held in abeyance pending determination by the Michigan Supreme Court of another suit (Appendix A, *infra* Page A-26) and on January 15, 1986, the Application was denied (Appendix A, *infra* Page A-28). A timely Application for Reconsideration of the Denial of Leave to Appeal was filed on February 3, 1986. (Appendix C, *infra* Page C-91), which Application for Reconsideration was denied on April 29, 1986, (Appendix A, *infra* Page A-30). On April 14, 1986, the United States Supreme Court granted an Order extending until June 13, 1986, the time to file a Petition for Writ of Certiorari. (Appendix A, *infra*, Page A-32).

Jurisdiction of the Supreme Court is invoked pursuant to 28 U.S.C. § 1257(3).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const. amend. XIV § 1

Sec. 1 All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. *No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.*

Mi. Const., art. IV § 24

No law shall enbrace more than one object, which shall be expressed in its title. No bill shall be altered or amended on its passage through either house so as to change its original purpose as determined by its total content and not along by its title.

Mi. Const., art. IV § 32

Every law which imposes, continues or revives a tax shall distinctly state the tax.

MICHIGAN OIL AND GAS SEVERANCE TAX

Mich. Comp. Laws Ann. § 205.301 - 205.317 (1986); Mich. Stat. Ann. § 7.351 - 7.367 (Callaghan 1984) (Appendix D, *infra*)

STATEMENT OF THE CASE

Petitioners are owners of mineral interests in Michigan which are leased to Shell Oil Company. As a matter of practice, Shell reduces the oil and gas royalties otherwise due Petitioners by a *pro rata* portion of the Michigan oil and gas severance tax levied on Shell as a producer engaged in the business of severing oil and gas from the soil. In 1981, Petitioners filed suit, as a class action, in the Circuit Court for Grand Traverse County, Michigan, challenging the propriety of Shell Oil Company's practice. Petitioners contended that, as mere owners of minerals leased to Shell, and therefore royalty owners, they are not "engaged in the business of severing" oil or gas. Thus the severance tax is obviously not their obligation.

The title and enactment section of the tax statute, Mich. Comp. Laws Ann. § 205.301 - 205.317 (1986); Mich. Stat. Ann. §7.351 - 7.367 (Callaghan 1984) provide in part:

> (TITLE) "An act levying a *specific tax* to be known as the severance tax upon all *producers engaged in the business of severing* oil and gas from the soil; . . ." (*emphasis supplied*).
>
> (ENACTMENT) "Sec. 1. There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax."

The Severance Tax Statute contains no provision authorizing Shell to pass the tax on to royalty owners.

Prior to acting on Petitioners' prayer for Class Action certification, the Circuit Court granted Shell partial summary judgment. While noting on the Record that its determination of the nature and scope of the tax was one of first impression, and that it would feel more comfortable in its conclusion and save time if the appellate courts either reversed or affirmed its decision (Appendix A, *infra*, Page A-22, 23), the Circuit Court ruled:

(a) because Petitioners are owners of mineral interests leased to Shell Oil Company pursuant to Shell lease forms, they, "as a matter of law, are producers engaged in the business of severing from the soil oil and gas," (Appendix A, *infra* Page A-12) and

(b) because Petitioners are "producers engaged in the business of severing" they "are bound to bear a portion of . . ." the tax. (Appendix A, *infra* Page A-12)

Petitioners appealed the Circuit Court's grant of Partial Summary Judgment to the Michigan Court of Appeals, contending that

(a) by alleging in their Complaint that they were not "engaged in the business of severing", Petitioners had raised a factual issue which entitled them to a trial on that issue, and

(b) the language of the statute does not require Petitioners, the owners of simply royalty interests, to bear a portion of the severance tax, since Petitioners are not "in the business of severing from the soil oil or gas."

Petitioners' urged that the Circuit Court had erred when it interpreted the statute to include Petitioners as "producers engaged in the business of severing . . .," when they were instead mineral owners who had simply leased property to Shell. In support of that position Petitioners cited a 1963 Michigan Attorney General's Opinion, 1963 OAG No. 4160., P. 118, which the Court of Appeals recognized in its Opinion supported Petitioners' view that the severance tax is not the responsibility of the holders of royalty interests. *Brown* v *Shell Oil Co.*, 128 Mich. App. 111, 115, 339 N.W.2d 709 (1983) (Appendix A, *infra*, Page A-6) Petitioners also cited decisions from other jurisdictions[2] which held that royalty owners are not in fact in the business of producing or sever-

[2] *Burbank* v *Sinclair Prairie Oil Co.*, 304 Ky. 833, 202 S.W.2d 420 (1946). Relying in part on *Oliver Iron Mining Co.* v *Lord*, 262 U.S. 172, 67 L.Ed. 929, 43 S.Ct. 526, 528, the Kentucky Supreme Court held that a

(Footnote continued on next page)

ing oil and gas and decisions which held taxing statutes unconstitutional as a matter of state law. *Ohio Oil Co.* v *Wright*, 386 Ill. 206, 53 N.E. 2nd 966 (1944) and *Cole* v *Pond Fork Oil & Gas Co.*, 127 W.Va. 762, 35 S.E. 2nd 25, *cert. denied*, 326 U.S. 765, 90 L.Ed. 461, 66 S. Ct. 147 (1945).

In *Ohio Oil* and *Cole*, the legislatures of Illinois and West Virginia, respectively, attempted to include royalty owners within the scope of occupation and privilege taxes when in fact mere royalty owners are neither producers nor "in the business" of producing or severing. In *Ohio Oil*, the Illinois Supreme Court concluded that it was unconstitutional (under the Illinois Constitution) for the legislature to define royalty owners as producers when in fact they were

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tax on "every person, firm, corporation or association producing crude petroleum . . . cannot be construed as placing any part of the tax in question on one who is simply royalty owner."

Byrne v *Fulton Oil Co.*, 85 Mont. 329, 278 P. 514 (1929). While noting that an occuption tax imposed on persons engaged in the business of producing oil is not an obligation of royalty owners, the Supreme Court of Montana concluded that because a tax on the net proceeds of mines and mining interests was assessed by the State Board of Equalization, that tax was a property tax, an obligation of the royalty owners.

Norum v *Ohio Oil Co.*, 83 Mont. 353, 272 P. 534 (1928). In analyzing a tax on "every person engaging in or carrying on the business of producing oil" the Supreme Court of Montana said "the language employed appears clear, free from ambiguity, and is easy of interpretation. It imposes an occupation license tax, as distinguished from a property tax and applies only to persons *engaged* in the *business* of producing oil. The owner of the land, as such, is not engaged in the *business* . . ."

Kanawha Valley Bank v *United Fuel Gas Co.*, 121 W. Va. 96, 1 S.E.2d 875 (1939). Drawing the distinction between a gross production tax and a licensing, privilege or occupation tax, the West Virginia Supreme Court considered the state "production tax" imposed on the operator "engaged in the business of producing gas for sale, etc." was not properly chargeable to a royalty owner by an operator who reduced royalty payments by a pro rata share of the tax.

State of Oklahoma v *State of Texas*, 266 U.S. 299, 69 L.Ed. 296, 45 S.Ct. 101 (1924). A "gross production tax" defined as "An occupation tax . . . laid upon all who engage in producing crude oil from wells within the state (of Texas)" was held to not be properly deducted from royalty proceeds.

not. The Illinois Supreme Court expressed the constitutional guarantees which the Illinois legislature had violated when it endeavored to include royalty owners within the taxpayer class of "producers engaged in the business of producing oil:"

> "The legislature does not have the power by legislation to declare that not to be a fact which everyone knows is a fact (citation omitted), and, by the same reasoning, cannot legislate that to be a fact which everyone knows is not a fact. To make the fact of ownership of oil, alone, the criterion of engaging in business of producing oil so obviously includes persons who may not and cannot be in such business as to render it obnoxious to the Constitution." *Ohio Oil*, 53 N.E.2d at 971.

In *Cole*, the West Virginia legislature had sought to expand by amendment a privilege tax levied upon persons engaged in the business of producing natural resources, to include, as taxpayers, persons whose only activity was the collection of royalties. In an effort to encompass the owners of royalty interests as taxpayers, the legislature authorized those persons "engaged in the business" of producing natural resources to deduct a portion of the tax from royalties otherwise due royalty owners. Citing *Ohio Oil* and a companion Illinois Supreme Court case, *Frederick* v *Wright*, 386 Ill. 229, 53N.E.2d 974 (1944), the West Virginia Supreme Court ruled:

> "'The owner of an oil royalty, who has no control over production of oil and who receives only a part of the oil as royalty, is not engaged in an 'occupation' and is not subject to an 'occupation tax;'" and ". . . the Legislature does not have the power to declare that not to be a fact which everybody knows is a fact; and that by the same reasoning cannot legislate that to be a fact which everybody knows is not a fact." *Cole*, 35 S.E.2d at 29.

Within their opinions, the Illinois Supreme Court and the West Virginia Supreme Court discussed and distinguished *Barwise* v *Sheppard*, 299 U.S. 33, 81 L.Ed. 23, 57 S.Ct. 70 (1936). In *Barwise*, this Court recognized that, although imposing an occupation tax on royalty owners could be a violation of royalty owners' 14th Amendment rights to Due Process, a tax on production, as distinct from an occupational tax on producers was, in that case (under the law of Texas), a valid excise tax for which royalty owners could be responsible. The decisions in *Ohio Oil* and *Cole* distinguished *Barwise* as involving a tax on production rather than a privilege tax as in *Cole* or an occupation tax on producers as in *Ohio Oil*.

Petitioners herein argued to the Michigan Court of Appeals that if that Court affirmed the Circuit Court's interpretation of the statute, i.e. that royalty owners "as a matter of law, are producers engaged in the business," the resulting situation would be parallel to that found in both *Ohio Oil* and *Cole* and the statute as so interpreted would be equally unconstitutional. Shell responded that Petitioners' position that they were not in the business was "ludicrous". Shell contended that because of Petitioners' ownership of leased mineral interests and the substantial income they might realize, Petitioners were in the business and therefore subject to the tax. (Respondent's Brief, Appendix C, *infra*, Page C-34, C-35)

The Court of Appeals did not address the explicit and implicit constitutional problems posed in *Ohio Oil* and *Cole*, stating, "Plaintiffs did not raise any constitutional challenge in this case." *Brown*, 128 Mich. App. at 117. Instead, while acknowledging that the tax statute includes the phrase qualifying producers to those "engaged in the business" (*Id.* at 116), the Court discussed with favor decisions upholding taxes on production which were treated as "property taxes rather than a license, privilege or occupation tax only on the operator." *Id.* at 118. The Court of Appeals stated: "This distinction between a gross proceeds-type of tax and a

licensing or privilege tax is also relevant here" (*Id.* at 118), and concluded that the severance tax "is not in the nature of a business, licensing, privilege, or occupational tax." *Id.* at 119.The Court affirmed the Circuit Court grant of partial summary judgment "because we find that the language of the severance tax includes Plaintiffs as a matter of law as producers who must pay their share of the tax." *Id.* at 119.

Petitioners applied to the Court of Appeals for rehearing and filed a supplemental application which noted the possible familial relationship between judge D.E. Holbrook, Jr., who presided over the panel hearing the appeal, and Donald E. Holbrook, Secretary of Grant Oil Company, which familial relationship was confirmed by Shell Oil Company. (Appendix C, *infra* at Page C-46).

Upon the Court of Appeals' rejection, without comment, of Petitioners' Application for Rehearing, Petitioners applied to the Michigan Supreme Court for Leave to Appeal, again urging that the Court of Appeals' affirmation of the Circuit Court's ruling renders the statute constitutionally unsound, and challenging the propriety of the Court of Appeals' panel being presided over by a judge with an apparent conflict of interest. (Appendix C, *infra* at Page C-46 - C-65). The Michigan Supreme Court held Petitioners' Application in abeyance (Appendix A, *infra*, Page A-26) for more than two years pending that Court's determination in *Mobil Oil Corp.* v *Dept. of Treasury*, 121 Mich. App. 293, 328 N.W.2d 367 (1982), aff'd 422 Mich. 473, 373 N.W.2d 730 (1985). In *Mobil Oil*, the Michigan Supreme Court ruled that owners of royalty interests are not producers: "The landowner-lessor, in oil and gas leases of this type is not involved in production at all but is merely a passive recipient of income.", *Id.* at 499. Nonetheless, on January 15, 1986, the Michigan Supreme Court denied Petititioners' Application for Leave to Appeal (Appendix A, *infra*, Page A-28). Petititioners promptly applied to the Michigan Supreme Court for Reconsideration of its Denial of Leave to Appeal (Appendix C, *infra*, Page C-93), setting forth in detail not only conflicts

between the Court of Appeals' decision and contemporaneous decisions of the Michigan Court of Appeals and the Michigan Supreme Court (*Id.* at C-100, and C-105), but also highlighted the State and Federal Constitutional violations (*Id.* at C-110) which arose when the Court of Appeals interpreted the Severance Tax Statute to be "not in the nature of a business, licensing, privilege or occupational tax" so as to include royalty owners as "producers who must pay their share of the tax." Petitioners argued that the Michigan Court of Appeals' conclusion that Petitioners were "producers" under the Michigan severance tax act and thus obligated to bear the tax burden denied Petitioners their constitutional rights to Due Process guaranteed under the 14th Amendment to the United States Constitution, and provisions of the Michigan Constitution. The Motion for Reconsideration was denied. (Appendix A, *infra* Page A-30)

ARGUMENT FOR GRANTING WRIT

The chain of events in the appellate proceedings in this case to date are peculiar, and have resulted in the denial of Petitioner's 14th Amendment Due Process rights. The Michigan Courts, upon construing the Michigan severance tax act in a manner repugnant to both the United States and Michigan Constitutions resulting in the imposition of the tax upon Petitioners, thereafter denied Petitioners the opportunity to challenge that construction.

A. PETITIONERS ARE ENTITLED TO A WRIT OF CERTIORARI

The Michigan Court of Appeals interpreted the Michigan severance tax statute in a manner repugnant to the plain language of the statute, in violation of Petitioners' constitutional rights, thereby approving Shell Oil Company's practice of subtracting a portion of Petitioners' royalty payments as a pro rata share of the severance tax. Such wrongful interpretation was itself a denial of Petitioners' constitutional right to Due Process. *Ward* v *Love County*, 253 U.S. 17, 64 L.Ed. 751, 40 S.Ct. 419 (1919). Petitioners are entitled to invoke the judgment of the Supreme Court of the United States by a Petition for Writ of Certiorari to inquire not only whether a particular right was denied in expressed terms, but also "whether it was denied in substance and effect, as by putting forward non-federal grounds of decision that were without any fair or substantial support." *Id.* at 22. The Court should "review a state court's interpretation of its statute . . . when that interpretation is an 'obvious subterfuge to evade consideration of a (constitutional) issue,'"[*Mullaney* v *Wilbur*, 421 U.S. 684, 685, 691 n. 11, 95 S.Ct. 1881, 1883, 1886 n. 11, 44 L.Ed. 2d 508, 511, 519 n. 11 (1975) citing as authority *Ward*, 253 U.S. at 22] particularly where the father of the presiding judge of the deciding tribunal could have a financial interest in the outcome. *Aetna Life Ins. Co.* v *Lavoie*, 475 U.S. , 89 L.Ed. 2d 823, 106 S.Ct. (1986).

B. PETITIONERS RAISED FEDERAL CONSTITUTIONAL ISSUES AT THE FIRST REASONABLE OPPORTUNITY

At issue in the present controversy are two distinct federal constitutional questions. First, is the Michigan Severance Tax as interpreted by the Michigan courts invalid under the principles of Due Process guaranteed by the 14th Amendment to the United States Constitution? Second and more importantly, did the Michigan Court of Appeals violate Petitioners' 14th Amendment rights to due process when, by forced construction of the language of the tax statute, the Court construed the nature of the tax to be other than that obvious on its face, thereby avoiding consideration of constitutional issues presented to the court?

Prior to the Court of Appeals' decision, no violation by the Michigan courts of Petitioners' federal and state constitutional rights to due process appeared obvious or contemplated. The Circuit Court had found, simply, that as owners of mineral interests leased to Shell Oil Company pursuant to Shell lease forms, Petitioners, "as a matter of law, are producers engaged in the business of severing from the soil oil and gas." The issue presented to the Michigan Court of Appeals was whether the Circuit Court had erred in that finding.

Petitioners argued that the Circuit Court had erred, citing as authority decisions from other states. Those decisions included decisions holding unconstitutional legislation which mandated that royalty owners were to bear a portion of a tax on producers engaged in the business of severing or producing oil or gas. *Ohio Oil*, *supra*, and *Cole supra*. All cited precedents uniformly agreed that royalty owners are not engaged in the production of oil and gas at all and hence,

could not permissibly be considered producers engaged in the business.[3]

In *Ohio Oil*, the Supreme Court of Illinois ruled on the constitutionality of the following definition contained in the Illinois Oil Producers' Tax Act:

> "'Producer' or 'person engaged in the business of producing oil' means any person owning oil or having a royalty interest therein at the time it is taken from the earth or water in this State, whether taken by him or by some other person in his behalf." *Ohio Oil*, 53 N.E.2d at 968.

In holding the entire statute invalid, the Supreme Court of Illinois discussed, at length, taxing statutes which sought to impose excise taxes on royalty owners.

> "This subject has engaged the attention of courts many times in construing statutes imposing excise taxes, and in most instances it has been held the receipt of income or rent constituted neither engaging in business nor being a producer." *Id.* at 970.

Relying upon rules announced by this Court,[4] the Illinois Supreme Court concluded:

> "If a corporation is not engaged in business by distributing income, a fortiori a land owner cannot be in the

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[3] Subsequent to the Court of Appeals' decision in *Brown, supra*, the Michigan Supreme Court concluded in *Mobil Oil Corp.* v *Department of Treasury*, aff'd 422 Mich. 473, 499, 373 N.W.2d 730 (1985) that a royalty owner "is not involved in production at all, but is merely a passive recipient of income." At least one commentator has already noted the inconsistancy between the Michigan Supreme Court decision in *Mobil Oil* and the Court of Appeals' decision in *Brown*. John G. Cameron, Jr., Michigan Real Property Law, §2.09 (1986 Supp., Page 4)

[4] *McCoach* v *Minehill & Schuylkill Haven Railroad Co.*, 228 U.S. 295, 57 L.Ed. 842, 33 S.Ct. 419 (1913). "In our opinion the mere receipt of income from the property leased (the property being used in business by the lessee, and not by the lessor) and the receipt of interest and dividends from invested funds, bank balances, and the like, and the distribution thereof among the stockholders of the Minehill Company, amount to no more than receiving the ordinary fruits that arise from the ownership of property." *Id.* at 306.

business of producing by merely accepting the value of a royalty for the oil which the lessee has by mining operations taken from the land." *Id.* at 971.

The Illinois statute was ruled unconstitutional because,

> ". . . the legislature has attempted to say that one who in fact is not in business, or is not in fact a producer, is one by legislative fiat,"

an act beyond the scope of legislative power. *Id.* at 971.

> "It manifestly is not a fact that such royalty owners are in the business of producing oil any more than a stockholder by accepting the dividends from a corporation is in the corporate business, whether the dividends be cash or property in kind. The legislature does not have the power by legislation to declare that not to be a fact which everyone knows is a fact (citation omitted), and, by the same reasoning, cannot legislate that to be a fact which everyone knows is not a fact. To make the fact of ownership of oil, alone, the criterion of engaging in business of producing oil so obviously includes persons who may not and cannot be in such business as to render it obnoxious to the constitution." *Id.* at 972.

Had the Michigan statute contained a provision equivalent to the "producer" definition found in the Illinois Statute, a violation of due process under both the Michigan Constitution and the 14th Amendment to the Federal Constitution would have been obvious, as an attempt to legislate against the fact. Petitioners properly raised that constitutional issue in their Appeal to the Court of Appeals, urging that if the language of the act as interpreted by the Circuit Court includes royalty owners as "producers engaged in the business" of severing, the statute would be equally constitutionally infirm on due process grounds. (Appendix C, *infra*, Page C-22)

The Court of Appeals sidestepped the constitutional issues in *Ohio Oil* and the other cases cited by Petitioners

and reached a holding, without precedent, that the tax is not in the nature of a privilege, business, occupational or licensing tax, a holding both at odds with not only the plain language of the act, and the interpretation implicit in the Circuit Court decision, but also the interpretation of the nature of the tax expressed by both Petitioners and Shell.

The violation of the Petitioners' 14th Amendment rights here complained of was brought about by the Court of Appeals' surprising decision. The first true opportunity to address the constitutionality of that action by the Court of Appeals was by appeal to a higher tribunal. Appeal to the Supreme Court of Michigan has been denied although the issue of improper forced construction by the Court of Appeals was raised.

In this case, the Michigan Court of Appeals, not the Michigan Legislature, created the constitutional infirmity.

> "The violation is none the less clear when that result is accomplished by the state judiciary in the course of construing an otherwise valid state statute. The federal guaranty of due process extends to state action through its judicial, as well as through its legislative, executive, or administrative, branch of government." [Citations and footnotes omitted.] *Brinkerhoff-Faris Trust & Savings Co.* v *Hill*, 281 U.S. 673, 679, 74 L.Ed. 1107, 1113 (1930).

C. PETITIONERS WERE WHOLLY SURPRISED BY THE COURT OF APPEALS' UNPRECEDENTED RULING THAT THE MICHIGAN SEVERANCE TAX WAS "NOT IN THE NATURE OF A BUSINESS, LICENSING, PRIVILEGE, OR OCCUPATIONAL TAX."

It has long been understood that "If a tax is imposed directly by the legislature without assessment and its sum is measured by the amount of business done . . . irrespective of the nature or value of the taxpayer's assets, it is regarded

as an excise." Annot., 103 A.L.R. 19 (1936), citing as authority *Society for Savings* v *Coite*, 73 U.S. (6 Wall.) 594, 18 L.Ed. 897 (1868). In Michigan, "An excise is a tax imposed upon the performance of an act, the engaging in an occupation, or the enjoyment of a privilege." *Dooley* v *Detroit*, 370 Mich. 194, 206, 121 N.W.2d 724 (1963).

As the Michigan severance tax is imposed without asssessment, Petitioners reasonably expected that it would be treated as an excise.[5]

The Court of Appeals' first impression determination that the severance tax was "not in the nature of a business, licensing, privilege or occupational tax" ignored these principles and the recognized qualifying phrase "engaged in the business", *Brown*, 128 Mich. App. at 116. Neither the Circuit Court, Petitioners nor Respondent had ever suggested that the nature of the tax was anything other than a business, occupational, or privilege tax. The language of the statute itself, both in its title and body, consistently defines the tax as being a "specific tax . . . levied upon all producers engaged in the business of severing . . ." oil and gas. Also, there can be no question that the Circuit Court considered the severance tax as a privilege, occupation or business tax; it predicated its grant of Summary Judgment on its ruling that as a matter of law Petitioners "are producers engaged in the business of severing from the soil oil and gas." Had the Circuit Court considered the tax as anything other than a privilege, business or occupation tax, such a predicative ruling would have been wholly unnecessary.

Disregarding the express language of the statute and the positions taken by the litigants before it, the Court of Appeals concluded that the tax was "not in the nature of a business, licensing, privilege or occupational tax", basing that conclusion on unwarranted significance placed upon

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[5] The Michigan Attorney General in 1961 treated the severance tax as a tax on a privilege. 1961 OAG., No. 4010, at page 591 (Appendix B, *infra*, Page B-4)

Section 15 of the act, a section unchanged since the tax was initially enacted in 1929 (*Appendix* D, *infra*, at Page D-6). Mich. Comp. Laws Ann. §205.315 (1986); Mich. Stat. Ann. §7.365 (Callaghan 1984). That section provides in substance that the severance tax is:

> "in lieu of all other taxes, state or local, upon the oil or gas, the property rights attached thereto or inherent therein, or the values created thereby; . . ."

With no explanation for its disregard of the statutory language limiting the tax to those "engaged in the business," the Court of Appeals equated the severance tax to a property tax assessed on the gross production of oil produced as distinct from "a license, privilege, or occupation tax on only the operators," *Brown*, 128 Mich. App. at 118, further noting that a gross production tax, as in a case the Court cited, was "assessed in lieu of other taxes upon the land." *Id.* at 118.

The Court concluded:

> "because the severance tax is in lieu of other related property taxes, it is assessable against royalty holders as well as lessees who are actually engaged in the business of severing the oil or gas from the soil. Section 15 clearly indicates that the severance tax is not in the nature of a business, licensing, privilege, or occupational tax." *Id.* at 119.

Reaching that conclusion, the court ignored the obvious, that "a tax laid on those who are engaged in [the] business, and laid on them solely because they are so engaged, as is the case here, is an occupation tax." *Oliver Iron Mining Co.* v *Lord*, 262 U.S. 172, 177, 67 L.Ed. 929, 935 (1923).

The convoluted reasoning and surprise conclusion of the Court of Appeals could in no way have been anticipated by Petitioners. The Michigan Court of Appeals itself, in *Market Place* v *City of Ann Arbor*, 134 Mich. App. 567, 579, 351 N.W.2d 607, (1984)[6] decided nine months after *Brown*, rec-

[6] The opinions in both *Brown* and *Market Place* were written by the same appellate court judge, Harold Hood.

ognized that it was error to conclude that a tax was other than a privilege tax upon a business activity simply because the tax was levied "in lieu of property taxes". Yet, the *Brown* court predicated its conclusion on just such false reasoning, and that forced reasoning and conclusion is now the decision of the highest state court in Michigan, as the Supreme Court of Michigan without elaboration has denied both Petitioners' Application for Leave to Appeal and Petitioners' Application for Reconsideration. Although the Court of Appeals' reasoning flies in the face of established legal principles and the constitutional requirements discussed in detail in the Petitioners' Application for Leave to Appeal (Appendix C, *infra*, Page C-39), the supplements thereto (Appendix C, *infra*, Pages C-83 and C-87) and Petitioners' Application for Reconsideration (Appendix C, *infra*, Page C-91), Petitioners have not been allowed to squarely address that reasoning and surprising conclusion which resulted in the imposition of the tax upon them, and thus have been denied their right to Due Process guaranteed by the 14th Amendment to the U. S. Constitution.

D. THE COURT OF APPEALS' DECISION CONSTITUTED FORCED CONSTRUCTION, IMPERMISSIBLE UNDER BOTH FEDERAL AND STATE LAW

The Court of Appeals' surprising affirmation of the Circuit Court's grant of Summary Judgment can only reflect that court's apparent determination to require royalty owners to bear a portion of the tax despite the plain language of the statute, in both its title and body, limiting the tax to those "engaged in the business." The Court of Appeals' determination was evidenced by its forced construction regarding the nature of the tax. By that construction, the Court of Appeals violated the principle that "Going behind the plain language of a statute in search of a possibly contrary [legislative] intent is 'a step to be taken cautiously' even under the best of circumstances." *American Tobacco Co.* v *Patter-*

son, 456 U.S. 63, 75, 71 L.Ed. 2d 748, 102 S.Ct. 1534 (1982), quoted in *United States* v *Locke*, 471 U.S. , 85 L.Ed.2d 64, 76, 105 S.Ct. (1985). The reasoning of the Court of Appeals further violated the deference to be afforded to the supremacy of the legislature as well as the recognition that legislators typically vote on the language of a statute, requiring the courts to assume "the legislative purpose is expressed by the ordinary meaning of the words used." *Richards* v *United States*, 369 U.S. 1, 9, 7 L.Ed. 2d 492, 82 S.Ct. 585 (1962), quoted in *United States* v *Locke*, *supra*, 85 L.Ed.2d at Page 76. The principles followed in *Locke*, and *Richards*, are embodied in the title-object clause (Mi. Const. art. IV, §24) and the clear statement of tax clause (Mi. Const. art. IV, §32) of the Michigan Constitution.

> Sec. 24. No law shall embrace more than one object, which shall be expressed in its title. No bill shall be altered or amended on its passage through either house so as to change its original purpose as determined by its total content and not alone by its title.
>
> Sec. 32. Every law which imposes, continues or revives a tax shall distinctly state the tax.

On its face, the Court of Appeals' forced construction which Petitioners have to date been denied the opportunity to squarely address, is contrary to both constitutional requirements of the State of Michigan and principles of construction honored by this Court.

> "(In) statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer." *United States* v *Merriam*, 263 U.S. 179, 187, 68 L.Ed. 240, 44 S.Ct. 69 (1923).

The Court of Appeals' forced construction characterizing the nature of the tax in a manner conflicting with the obvious intention of the statute was a necessary first step

before the court could impose a share of the tax burden on royalty owners. By that construction, the Court of Appeals avoided the constitutional principles addressed in *Ohio Oil* and *Cole*. Such construction for such purpose is not permissible and petitioners should be given the opportunity by Writ of Certiorari to squarely address that construction. The Court of Appeals "cannot press statutory construction 'to the point of disingenuous evasion' even to avoid a constitutional question." *US* v *Locke*, *supra*, 85 L.Ed.2d at Page 77.

E. THE COURT OF APPEALS' DETERMINATION OF THE NATURE OF THE TAX IS NOT BINDING UPON THE UNITED STATES SUPREME COURT

The ruling of the Court of Appeals that the severance tax "is not in the nature of a business, licensing, privilege or occupational tax," although involving a matter of state law, is not controlling because of the constitutional issues involved. On basic facts roughly parallel to those here at issue, this Court in *Carpenter* v *Shaw*, 280 U.S. 363, 74 L.Ed. 478, 50 S.Ct. 121 (1920), on a Writ of Certiorari to the Oklahoma Supreme Court, rejected that State Court's determination of the character and incidence of an Oklahoma tax on oil and gas severed from the land.

In that case, in an effort to avoid a Federal exemption from taxation of lands, an exemption available to Choctaw Indians, and to confirm that the Indians were liable for a tax upon "the owner of any royalty" from petroleum or natural gas, the Supreme Court of Oklahoma had concluded that the tax was "imposed only on oil and gas when severed and so is a tax upon personalty not embraced within the exception." *Id* at 365. Rejecting that rationale, the United States Supreme Court ruled

> "Where a federal right is concerned we are not bound by the characterization given to a state tax by state courts or legislatures, or relieved by it from the duty of

considering the real nature of the tax and its effect upon the Federal right asserted. *Choctaw, O. & Gulf R. Co.* v *Harrison, supra; Galveston, H. & S.A.R.Co.* v *Texas*, 210 U.S. 217, 227, 51 L.Ed. 1031, 1037, 28 Sup. Ct. Rep. 638. We think it plain that the tax imposed on the royalty interest of the present Petitioners is not a tax on oil and gas severed from the royalties, but is, by its very terms, a tax upon the right reserved in them as lessors and owners of the fee." *Carpenter*, 280 U.S. at Page 367-368.

Equally, as the decision of the Court of Appeals regarding the nature of the severance tax was forced construction to avoid the constitutional issues addressed in *Ohio Oil* and *Cole*, that decision is not binding upon the U.S. Supreme Court.

F. PETITIONERS' RIGHTS MAY ONLY BE FULLY PROTECTED IN THESE PROCEEDINGS

Shell has asserted that constitutional issues should not be addressed in these proceedings wherein Shell is a party. (Respondent's Brief in Opposition to Petitioners' Application for Leave To Appeal, Appendix C, *infra*, page C-77.) By that assertion, Shell has suggested that a constitutional challenge would be more appropriate in other proceedings. *Therein lie the horns of a dilemma*. The proper adverse party for any such new proceeding directly challenging the constitutionality of the severance tax statute as interpreted by the Michigan Court of Appeals, would be the State of Michigan. Not having been a party to this action, and not being a party necessary to the determination of the issues raised in Petitioners' Complaint, i.e. the propriety of Shell's practice of reducing Petitioners' royalties, the state would not be bound in any such new proceeding by the decision of the Michigan Court of Appeals in this case. Pursuant to 28 U.S.C. 2403 (b), the state may intervene in this pr ceeding.

If this Petition is denied, Petitioners would be required to commence a new action in order to address the constitutional concerns raised herein. The likely result in such a new proceeding — assuming the correctness of Petitioners' interpretation of the application of federal and state constitutional principles — would be that the conclusion of the Court of Appeals would be found erroneous and the severance tax would be held to be a privilege, business or occupational tax which royalty owners are not "as a matter of law" obligated to bear.

With such a result, the Court of Appeals' decision would be corrected; however, the principles of *Res judicata* and the law of the case doctrine could bar petitioners from reasserting their claim that Shell Oil Co. improperly charged them with a *pro rata* portion of the severance tax. The law of the case doctrine in Michigan is a strict one. As most recently discussed in *People* v *Russell*, 149 Mich. App. 110, 135 N.W.2d 613 (1985).

> " 'The policy of the law is that when a case has once been considered and disposed of by the courts before which it may lawfully be brought, it is disposed of for all time, and the conclusion cannot be attacked in any new proceeding except upon certain equitable grounds which are foreign to the present discussion,' " citing *Lyon* v *Ingham Circuit Judge*, 37 Mich. 378, 378-379 (1877).
>
> " 'It is fundamental law that the last utterance of an appellate court determines the law of the case, and upon remand for another trial subsequent to the appeal, the trial court is bound to follow the law as stated by an appellate court. If a litigant has any objection to the law as stated by the appellate court, his redress is an application for rehearing to the deciding court or an appeal to a still higher tribunal,' " citing *People* v *Whisenant*, 19 Mich. App. 182, 189; 172 NW2d. 524 (1969).

The result of denying this Petition and requiring Petitioners to instead commence a new action to squarely

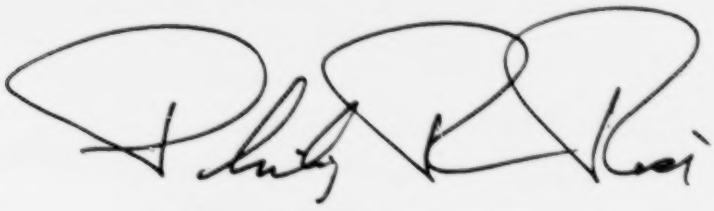
address the basic constitutional issues arising under the state and federal constitutions could, if Petitioners were successful in that action, result in a proper clarification of the severance tax for the benefit of others, but afford Petitioners no relief. The issues arose, not from any action of the Petitioners, or indeed the Respondent, but rather from forced judicial construction. Such a result would be manifest injustice to Petitioners which can best be avoided by granting the Writ of Certiorari sought herein. As this Court noted in *Brinkerhoff*, 281 U.S., at Page 679:

> "If the judgment is permitted to stand, deprivation of plaintiff's property is accomplished without its ever having had an opportunity to defend against the exaction."

CONCLUSION

The Michigan Courts have denied Petitioners the opportunity in their action against Shell Oil Company to challenge the violation of Petitioners' federal and state constitutional rights resulting from the Michigan Court of Appeals' extraordinary interpretation of the nature and incidence of the Michigan severance tax. Justice demands that Petitioners be afforded an opportunity to squarely address the constitutional issues arising from that decision in the context of this litigation against Shell, litigation in which they have been subjected to Summary Judgment. If a Writ does not issue, Petitioners will have been deprived of their property without ever having had an opportunity to defend against the exaction. A Writ of Certiorari to the Michigan Court of Appeals should issue.

Respectfully submitted,



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NO. A-771

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

ALBERT K. BROWN; CATHERINE D. BROWN; KENT ROSENBERG; ARLENE ROSENBERG; VICTOR SCHULER; ELIZABETH SCHULER; DONALD E. WOOD; ELLEN L. WOOD; AMERICAN NATIONAL BANK, a State Banking Corporation, Trustee under the EARL HILLIARD TRUST; MARGARET HILLIARD; JEROME A. RAY; KAREN M. RAY and KENNETH R. HILLIARD
Petitioners

v

SHELL OIL COMPANY, a Delaware Corporation,
Respondent.

APPENDIX

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APPENDIX A

OPINIONS AND ORDERS OF THE GRAND TRAVERSE COUNTY CIRCUIT COURT, THE MICHIGAN COURT OF APPEALS, AND THE MICHIGAN SUPREME COURT

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BROWN v SHELL OIL COMPANY

Docket No. 63011. Submitted April 8, 1983, at Lansing.—Decided August 16, 1983. Leave to appeal applied for.

Albert K. Brown and other holders of royalty interests as lessors of mineral rights in oil wells owned and operated by defendant, Shell Oil Company, brought an action in Grand Traverse Circuit Court challenging, among other things, Shell's practice of withholding from royalty payments a pro-rata share of the state severance tax on oil and gas. The trial court, Charles M. Forster, J., granted defendant summary judgment on the severance tax claim, holding that the tax statute defined the plaintiffs as producers who were required to pay their proportionate share of the tax and that, therefore, plaintiffs had failed to state a claim upon which relief could be granted with regard to Shell's withholding of the taxes from the royalty payments. Plaintiffs appeal, alleging that they are not subject to the tax because they are not "engaged in the business of severing from the soil, oil or gas" and that summary judgment was improperly granted because they had raised a question of fact by denying that they were so engaged. *Held*:

1. Payment of the severance tax is the responsibility of all "producers", as defined in the statute, including holders of royalty interests such as plaintiffs, due to a 1965 amendment to the statute, notwithstanding a separate provision which retains the original qualification of a producer as one "engaged in the business of severing from the soil".

2. A further reason for assessing the severance tax against holders of royalty interests as well as lessees actually engaged in severing the oil or gas from the soil is that the severance tax is in lieu of other related property taxes.

3. Plaintiffs are, as a matter of law, producers who are subject to payment of their share of the severance tax. They therefore failed to state a cause of action upon which relief

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REFERENCES FOR POINTS IN HEADNOTES

[1] 73 Am Jur 2d, Statutes §§ 145, 146.
[2] 73 Am Jur 2d, Statutes § 343.
[3] 71 Am Jur 2d, State and Local Taxation §§ 219, 220.
[4] 71 Am Jur 2d, State and Local Taxation § 614.

could be granted and did not raise an issue of fact. Summary judgment was proper.

Affirmed.

1. STATUTES — JUDICIAL CONSTRUCTION.

The primary rule of statutory construction is to ascertain and enforce the legislative intent in enacting the provision in question, reviewing the language in the context of the entire act and its amendments.

2. STATUTES — JUDICIAL CONSTRUCTION — AMENDMENTS TO STATUTES.

An amendment is generally construed as changing the meaning of a statute, and an amended statute should be interpreted in light of court decisions which prompted the amendment and should be liberally construed so as to correct defects in predecessor statutes.

3. TAXATION — OIL AND GAS — SEVERANCE TAX — PRODUCERS.

A lessor of mineral rights holding a royalty interest is a "producer" for purposes of the statute imposing a severance tax on producers of oil and gas, and is therefore subject to payment of a pro-rata share of the tax (MCL 205.303, 205.312[2]; MSA 7.353, 7.362[2]).

4. TAXATION — OIL AND GAS — SEVERANCE TAX.

The oil and gas severance tax is in lieu of all other property taxes upon the oil or gas, the property rights attached thereto, leases or rights to develop and operate the land, and any values created by the property rights or leases (MCL 205.315; MSA 7.365).

Thompson, Zirnhelt, Bowron, Senger & Rosi, P.C. (by *Philip R. Rosi*), for plaintiffs.

Foster, Swift, Collins & Coey, P.C. (by *Webb A. Smith* and *Scott A. Storey*), and *Lynam & Flynn* (by *Terence V. Lynam*), for defendant.

Before: D. E. HOLBROOK, JR., P.J., and HOOD and T. M. GREEN,* JJ.

HOOD, J. Plaintiffs appeal as of right from a Grand Traverse County Circuit Court order grant-

* Circuit judge, sitting on the Court of Appeals by assignment.

ing defendant partial summary judgment, GCR 1963, 117.2(1).

Plaintiffs are holders of royalty interests as lessors of mineral rights in oil wells owned and operated by defendant, Shell Oil Company. Shell deducts a pro-rata share of the state severance tax on oil and gas, MCL 205.301 *et seq.*; MSA 7.351 *et seq.*, from plaintiffs' royalty interests. The leases between plaintiffs and Shell are silent regarding defendant's authority to withhold and deduct such taxes from plaintiffs' royalties. Plaintiffs brought this suit to challenge this and other of Shell's practices.

The trial court rejected plaintiffs' claim that the severance tax statute did not authorize Shell to withhold a proportionate share of that tax from plaintiffs' royalty interests. Rather, the trial court ruled as a matter law that the statute defined plaintiffs as producers and, as such, that plaintiffs are required to pay their proportionate share of the severance tax. Thus, plaintiffs failed to state a claim in regard to Shell's practice of withholding a share of the severance tax from their royalties.

The statute authorizing a severance tax on oil and gas, 1929 PA 48, as amended by 1965 PA 299, states in part:

> "Sec. 1. There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax." MCL 205.301; MSA 7.351.
>
> " 'Producer' as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance." MCL 205.312(2); MSA 7.362(2).

In this appeal, plaintiffs concede that they are

producers as defined by the statute. Nevertheless, they argue that the trial court erred by finding them responsible for a proportionate share of the severance tax because they are not producers who are "engaged in the business of severing from the soil, oil or gas". Moreover, plaintiffs argue that, because they denied in their complaint that they were engaged in the business of severing, they raised a fact question that precludes the grant of summary judgment for failure to state a claim, GCR 1963, 117.2(1).

Shell argues that the trial court's statutory interpretation was correct because the Legislature's amendment to the statute in 1965 added the definition of producer in order to make holders of royalty interests proportionately responsible for payment of the severance tax.

This question of the interpretation of the statute authorizing an oil and gas severance tax is novel in this Court. We review the statute by applying the well-recognized rules of statutory interpretation and by reviewing cases in other jurisdictions which have interpreted similar statutes.

The primary rule of statutory construction is to ascertain and enforce the legislative intent in enacting the provision. *Melia v Employment Security Comm*, 346 Mich 544, 562; 78 NW2d 273 (1956). Insight into legislative intent must first be obtained by a review of the statute's language in the context of the entire act plus its amendments. *Kizer v Livingston County Board of Comm'rs*, 38 Mich App 239, 349-350; 195 NW2d 884 (1972). While every word and phrase of a statute is to be given effect, *Melia, supra*, an amendment is generally construed as changing the meaning of a statute. *Reinelt v Public School Employees' Retirement Board*, 87 Mich App 769, 774; 276 NW2d 858

(1979), *lv den* 407 Mich 855 (1979). Amended statutes should be interpreted in light of court decisions which prompted the amendment. *E F MacDonald Co v Dep't of Treasury*, 62 Mich App 626, 632; 233 NW2d 678 (1975). Amending legislation should be liberally construed so as to correct defects in predecessor statutes. *E F MacDonald, supra*.

Although there is no Michigan case law on point prior to the 1965 amendment, the Attorney General in OAG 1963-1964, No 4160, p 118 (June 17, 1963), did interpret the severance tax statute. In that opinion, the Attorney General said that payment of severance and privilege taxes are the primary responsibility of producers of oil and gas, not of holders of royalty interests. The opinion was prompted by the state's own Conservation Department questioning the practice by which oil companies holding leases from the state withheld from the state's 12-1/2% royalty interest a pro-rata share of both the severance tax and the separate privilege tax, MCL 319.22; MSA 13.139(22), before its amendment by 1973 PA 61. The Attorney General relied in part upon the commentator in Summers, The Law of Oil and Gas, § 801, p 410, who concluded that the pre-1965 severance tax statute did not require the royalty owner to bear any part of the then 2% severance tax upon the extracted gas and oil.

Section 1 of the severance tax act prior to 1965 stated:

> "There is hereby levied upon each corporation, association, or person engaged in the business of severing from the soil oil or gas, a specific tax to be known as the severance tax. * * *"

The 1965 amendment substituted the term pro-

ducer for corporation, association, or person and added the definition of that term in § 12. The 1965 amendment also altered the language of § 3 of the act which provides the tax rate, computation, payor, and method of withholding. The pre-1965 § 3 provided:

"The severance tax required to be paid by each producer at the time of rendering each monthly report, or by any pipe line company, common carrier or common purchaser, for and on behalf of any such producer, shall be in the amount of two (2) per cent of the gross cash market value of the total production of such oil or gas during the preceding monthly period. The value of all such production shall be computed as of the time when and at the place where the same have been servered or taken from the soil immediately after such severance. *Except as otherwise provided in this section, the payment of said severance tax shall be required of the severer or producer actually engaged in the operation of severing the oil or gas.*" MCL 205.303; MSA 7.353. (Emphasis added.)

The emphasized language above was amended in 1965 to provide: "Except as otherwise provided in this section, the payment of the severance tax shall be required of each producer."

We find that the 1965 amendment to the severance tax act was, in part, a reaction to OAG 1963-1964, No 4160, *supra*. Although § 1 still retains the phrase qualifying a producer as one "engaged in the business of severing from the soil * * *", the amended statute now requires the payment of the severance tax to be the responsibility of all producers, including holders of royalty interests. We note that § 3 now explicitly exempts the state, as a producer, from paying any severance tax.

We find additional support for this interpretation in cases from other jurisdictions. In some

decisions, similar statutes, even though explicitly allowing operators to withhold a pro-rata share of the tax from royalty interests, have been held unconstitutional. See *Cole v Pond Fork Oil & Gas Co*, 127 W Va 762; 35 SE2d 25 (1945), *cert den* 326 US 765; 66 S Ct 147; 90 L Ed 461 (1945) (statute invalid as impairing obligation of contract); *Ohio Oil Co v Wright*, 386 Ill 206; 53 NE2d 966 (1944) (statute was unconstitutional for lack of uniformity). Other jurisdictions have reviewed the specific language of their statutes and held that the gas or oil tax was to be assessed against the lessee only as the party engaged in the business of owning, controlling, managing, or operating the oil well. See *Norum v Ohio Oil Co*, 83 Mont 353; 272 P 534 (1928); *Burbank v Sinclair Prairie Oil Co*, 304 Ky 833; 202 SW2d 420 (1946).

Plaintiffs did not raise any constitutional challenges in this case. Instead, plaintiffs rely particularly on *Norum, supra*, for arguing that the qualifying language in § 1, "engaged in the business of severing", means that the Michigan Legislature intended only to assess the severance tax against lessee operators such as Shell. However, plaintiffs' reliance is misplaced. *Norum* dealt with a gross production licensing tax. In *Byrne v Fulton Oil Co*, 85 Mont 329; 278 P 514 (1929), the same court upheld the constitutionality of another Montana statute that permitted the lessee or operator to withhold a ratable portion of a net proceeds tax from the lessor's royalty interest. The Montana Supreme Court justified the distinction between the *Norum* decision and its decision in *Byrne* by finding the net proceeds tax to be in the nature of a property tax assessable against a holder of a royalty interest.

In *Kanawha Valley Bank v United Fuel Gas Co*,

121 W Va 96; 1 SE2d 875 (1939), the court followed the *Byrne* distinction between a gross production tax that is collected in lieu of other property taxes and the West Virginia statutory tax on oil and gas proceeds which was not a substitute for other property taxes. A similar analysis was followed in *Miller v Buck Creek Oil Co*, 38 Wy 505; 269 P 43 (1928). That court held that a gross production tax on oil produced could be proportionately withheld from a lessor's royalty interest by the payor operator. Such taxes were held to be property taxes rather than a license, privilege, or occupation tax on only the operators. The Wyoming statute explicitly stated that the gross production statute was assessed in lieu of other taxes upon the land.

This distinction between a gross proceeds-type of tax and a licensing or privilege tax is also relevant here. The severance tax act explicitly states:

> "Sec. 15. The severance tax herein provided for shall be in lieu of all other taxes, state or local, upon the oil or gas, the property rights attached thereto or inherent therein, or the values created thereby; upon all leases or the rights to develop and operate any lands of this state for oil or gas, the values created thereby and the property rights attached to or inherent therein: Provided, however, Nothing herein contained shall in anywise exempt the machinery, appliances, pipe lines, tanks and other equipment used in the development or operation of said leases, or used to transmit or transport the said oil or gas: And provided further, That nothing herein contained shall in anywise relieve any corporation or association from the payment of any franchise or privilege taxes required by the provisions of the state corporation laws." MCL 205.315; MSA 7.365.

Thus, we conclude that, assuming that the Attorney General was correct in stating that the oil

and gas severance tax was assessable only against lessee operators, the 1965 amendment to that act changed the act to provide that all producers, including those holding only royalty interests, were accountable for their pro-rata share of the tax. Moreover, because the severance tax is in lieu of other related property taxes, it is assessable against royalty holders as well as lessees who are actually engaged in the business of severing the oil or gas from the soil. Section 15 clearly indicates that the severance tax is not in the nature of a business, licensing, privilege, or occupational tax.

Because we find that the language of the severance tax act includes plaintiffs as a matter of law as producers who must pay their share of the tax, we agree with the circuit court that plaintiffs failed to state a cause of action. The plaintiffs did not raise a factual issue by alleging that they were not "engaged in the business" of severing oil and gas from the soil.

Affirmed.

Judgment of Grand Traverse County Circuit Court

STATE OF MICHIGAN
IN THE CIRCUIT COURT
FOR THE COUNTY OF GRAND TRAVERSE

ALBERT K. BROWN, CATHERINE D. BROWN, KENT ROSENBERG, ARLENE ROSENBERG, VICTOR SCHULER, ELIZABETH SCHULER, DONALD E. WOOD, ELLEN L. WOOD EARL HILLIARD, MARGARET HILLIARD, JEROME A. RAY, KAREN M. RAY, AND KENNETH R. HILLIARD,
Plaintiffs

vs File No. 81-8858-CK

SHELL OIL COMPANY, a Delaware corporation,
Defendant.

Philip R. Rosi (P31915)
Attorney for Plaintiffs

Webb A. Smith (P20718)
Scott A. Storey (P30232)
Terence V. Lynam (P26490)
Attorneys for Defendant

ORDER FOR PARTIAL SUMMARY JUDGMENT
(SEVERANCE TAX ISSUE)

At a session of said Court, held in the Circuit Courts for the County of Grand Traverse, City of Traverse City, State of Michigan, on this day of , 1982.

PRESENT: HONORABLE CHARLES M. FORSTER, Circuit Judge

Judgment of Grand Traverse County Circuit Court

Defendant Shell Oil Company having moved this Court for partial summary judgment, and the Court having reviewed Briefs filed by the respective parties and having listened to the oral argument of the parties, and the Court being fully advised in the premises and finding that there is no just reason for delay,

The Court makes the following findings:

1) Plaintiffs are owners of mineral interests leased to Shell Oil Company pursuant to Shell lease form LB-88-68 Michigan and/or Shell lease form Producers 88-Michigan (4/71) paid up, and therefore, as a matter of law, are producers engaged in the business of severing from the soil oil and gas.

2) Plaintiffs as producers engaged in the business of severing from the soil oil and gas, as a matter of law, are bound to bear a portion of any severance tax imposed upon the production of oil and gas from their properties, specifically the Michigan severance tax statute, MSA §7.351 *et seq*, MCLA §205.301 *et seq*.

IT IS HEREBY ORDERED AND ADJUDGED that Defendant's Motion for Partial Summary Judgment be granted and that Paragraphs 28 through 32 of Plaintiffs' Amended Complaint and Plaintiffs' prayer for judgment in a sum equal to the cumulative sum of all severance tax deducted by Defendant from Plaintiffs' royalties be dismissed with prejudice, and that final judgment to that effect is hereby entered.

/s/ CHARLES M. FORSTER, *Circuit Judge*
4-6-82

Approved for Entry, as to form:

/s/ Philip R. Rosi
Attorney for Plaintiffs

Excerpt of Court Transcript of
Circuit Court's Remarks

STATE OF MICHIGAN
IN THE CIRCUIT COURT
FOR THE COUNTY OF GRAND TRAVERSE

ALBERT K. BROWN, CATHERINE D. BROWN,
KENT ROSENBERG, ARLENE ROSENBERG,
VICTOR SCHULER, ELIZABETH SCHULER,
DONALD E. WOOD, ELLEN L. WOOD
EARL HILLIARD, MARGARET HILLIARD,
JEROME A. RAY, KAREN M. RAY, AND
KENNETH R. HILLIARD,
Plaintiffs

VS File No. 81-8858-CK

SHELL OIL COMPANY, a Delaware corporation,
Defendant.

AT A SESSION OF SAID COURT HELD IN THE COUNTY BUILDING IN THE CITY OF TRAVERSE CITY, COUNTY OF GRAND TRAVERSE, STATE OF MICHIGAN, THIS 3RD DAY OF MARCH, A.D. 1982.

BEFORE: HON. CHARLES M. FORSTER,
CIRCUIT JUDGE

APPEARANCES: THOMPSON, ZIRNHELT, BOWRON,
SENGER & ROSI
BY: PHILIP R. ROSI, ESQ. and
J. MICHAEL SENGER, ESQ.
Appearing on behalf of the
Plaintiffs

FOSTER, SWIFT, COLLINS & COEY
BY: WEBB A. SMITH, ESQ. and
SCOTT A. STOREY, ESQ.

and

TERENCE V. LYNAM, ESQ.
Appearing on behalf of the Defendant.

Excerpt of Court Transcript of Circuit Court's Remarks

THE COURT: All right. This is the matter of Grand Traverse County File Number 8858, Brown, et al versus Shell Oil Company. The Plaintiffs are represented by their attorneys, Mr. Rosi and Mr. Senger. Mr. Smith is representing Shell Oil Company.

Mr. Smith, did you have some other attorneys you wanted to place on the record?

MR. SMITH: Mr. Scott Storey from our office, who is on my left, your Honor, and on my right, Terry Lynam.

THE COURT: The Court understands this is the time and place scheduled for the hearing of a number of motions. I had an opportunity to meet with counsel in Chambers, and it is my understanding that we're in agreement to hear the motion for partial summary judgment on behalf of the Defendant involving the severance question as pertains to Paragraphs Twenty-Eight through Thirty-Two of the Plaintiff's Amended Complaint.

The Court wishes to advise counsel that I have had an opportunity to read your briefs. All right; Mr. Smith?

MR. SMITH: Thank you very much, your Honor. If the Court please, you are, indeed, correct that we are at this time asking the Court to rule on a portion of the amended complaint that we are dealing with in this case, that part which makes allegations regarding severance tax and charges back to the lessees of pro rata shares of that particular severance tax.

In our motion we have set forth what we believe to be sufficient factual basis upon — based upon the complaint to set forth what the issue is, and what we are actually talking about.

It is our position that under the severance tax statute that governs the collection of severance tax in the State of Michigan that, indeed, the Plaintiffs are producers as defined therein, and we have alleged then that as a matter of law we are entitled or that more accurately the Plaintiffs are required to pay pro rata share of the severance tax attribut-

able to the production from the Defendant's wells on the premises leased from the Plaintiffs, and for those reasons, your Honor, we think that as a matter of law on that paragraphs that we have cited, Twenty-Eight through Thirty-Two, that indeed we are entitled to partial summary judgment dismissing those paragraphs and that issue from this lawsuit.

THE COURT: Mr. Rosi?

MR. ROSI: Thank you, your Honor. At this stage of the proceedings is as the Defendant states in his brief to test only the legal and not the factual sufficiency of the pleadings. On the question of severance tax, Paragraphs Twenty-Eight, Twenty-Nine and Thirty of the pleadings assert that there is a severance tax, assert that the Plaintiffs are not engaged in the business of severing from the soil oil and gas.

Plaintiffs in their brief have addressed only one aspect of the statute. That is the aspect of the statute which imposes tax upon producers. They have ignored the words of the statute which state specifically the tax is imposed upon producers engaged in the business.

In order for this Court to grant the motion for summary judgment, should the Court feel disposed, the Court would have to make a finding of fact; namely, that the Plaintiffs' allegation Number Twenty-Nine, that the Plaintiffs are not engaged in the business of severing from the soil oil and gas is found contrary to the Plaintiff. The Court would have to make a conclusion, a factual conclusion, that the Plaintiffs are, indeed, engaged in the business, to make a factual determination goes beyond the motion for summary judgment, and indeed it would go beyond what the Defendants, themselves, acknowledge are the limits of this particular proceeding.

On the first page, I read again, the Defendant's motion tests only the legal, not factual sufficiency. The brief which we have filed in opposition to this motion points out divers authorities that unanimously conclude that in Michigan the severance tax is not imposed upon royalty owners.

Excerpt of Court Transcript of Circuit Court's Remarks

The Defendants, in their brief, have ignored the authorities we cited, and instead cite authorities which do not support the position, whatsoever. They have cited Williams, Oil and Gas Law 645.2, which in fact cites the Holbein case as supporting the proposition that severance taxes are proper charges.

The Holbein case, a case from the Fifth Circuit Court of Appeals, addressed the question of severance tax, took a look at the Texas statute which said severance tax is imposed upon royalty owners, and without more, proceeded to say that disposes of the question.

For the Court's use, we have a copy of that opinion. We, also, have a copy of Williams and Meyers lengthy citation. On the contrary, the Plaintiffs provided reference to the Court to Summers Treatise on Oil and Gas, in which Professor Summers looked at the subject in depth, and indeed analyzed the Michigan statute which has not substantially been changed. Professor Summers concludes that the tax is not imposed upon royalty owners, upon lessors.

Now, part of Professor Summers' analysis was directed to the question of in the business. Shell has ignored that section of the statute, and asked this Court to do so. We don't believe the Court can and should ignore the clear words of the legislature, which have been on the books for at least forty years, at the adoption of the statute in the first place. The motion for summary judgment should be denied.

THE COURT: Mr. Smith?

MR. SMITH: Thank you, your Honor. First of all, I think in terms of looking at this matter on whether it is ripe for summary judgment, it is necessary to view the complaint that was filed, not a particular paragraph here or there, but the entire complaint that was filed, and indeed, when you look at the complaint that was filed on behalf of the Plaintiffs, then it is clear that they come within the definition of a producer and as defined and as set forth in both of the briefs as far as the statute is concerned.

Excerpt of Court Transcript of Circuit Court's Remarks

I think it is absurd to suggest that one might pick out an isolated paragraph here or there and say, "Well, therefore, we may have dispute as to one paragraph, therefore, summary judgment is not appropriate." It simply isn't the case here.

They have made allegations as to what the relationship is between the Plaintiffs and the Defendant and we are simply saying that for purposes of this motion, let's assume for a minute that their allegations are true and under those circumstances they certainly fit within the definition of a producer under the oil and gas or under the severance tax. To suggest somehow that they have presented clear and convincing authority that the severance tax is not imposed upon royalty, I suggest, is simply not the case. I have read their brief a number of times trying to find that authority, and it isn't there.

I would not stand before you, your Honor, and tell you it is a crystal clear question that has been decided by the Michigan Supreme Court because very honestly it hasn't been. That's what we told you in our brief. We take no different position here today, but clearly based upon the statute, the Plaintiffs — the facts that they have alleged come within that and are producers and have to pay pro rata share of the severance tax.

I somehow am bothered by a statement that the severance tax statute has been the same for forty years, because as we point out, it was amended in 1965, after Summers' article, by the way, and that's when the definition of a producer was changed, so that it is today, and I think it makes it abundantly clear that, in fact, the legislature intended to cover precisely the Plaintiffs or people similarly situationed by that definition. They had opportunity to do otherwise, and they have not changed it, and frankly, this is a method that has been followed by lessees from time in memoriam in the State of Michigan, insofar as it relates to the severance tax, and obviously, the legislature can't be presumed to not

have knowledge of that and they have not chosen to change the language, which we think is abundantly clear and entitles us to the granting of our motion. Thank you.

THE COURT: Mr. Rosi?

MR. ROSI: One additional observation, your Honor. For the purpose of this motion, the Court should assume Paragraph Twenty-Nine of the complaint is true, that the Plaintiffs were not engaged in the business. There is no way, we submit, that if the Court holds that to be true, that the Court can find for the Defendants and say on one hand the Plaintiffs are not engaged in the business and yet they must be saddled with the tax, which the legislature specifically imposes upon persons who are engaged in the business. Thank you.

THE COURT: Mr. Rosi, how do you square that with Section 12.2 which gives us the definition of a producer?

MR. ROSI: Your Honor, I don't know what the history was. The legislature history in this state is very hard to come by. Why the language of producer was written to include the words that were chosen is anybody's guess. There is no question, however, that that particular change came about after the Attorney General's opinion.

The Attorney General's opinion also preceded another change which is very hard to justify except, perhaps, on political grounds or — that change, your Honor, is that after the Attorney General in his opinion which was cited said that the state is exempt from paying severance taxes because the lease doesn't order it, and the severance tax statute doesn't order it. A special statute was adopted which said essentially that if a producer drills on state land, no severance taxes are collectible. Now, that goes a long way from merely saying that the state no longer has to pay severance taxes.

When you are talking about the language of producer, we presume that the legislature intended to include the original three; namely, persons, corporations, and partnerships, but also, bring into account holders of working interests.

Excerpt of Court Transcript of Circuit Court's Remarks

Those are people who are investors, who are not operators of the well, and just for your information if the ABC Oil Company decided to drill a well, over in someone's backyard and they didn't have enough money to do it themselves, they would often go out and sell interests in that well, working interests. Those people are entitled to receive some interest. They, also, as a matter of course bear a share of the severance tax.

Perhaps, that's what the legislature was addressing, but one thing the legislature did do when it changed producers — changed the original words which were persons, corporations or partnerships to the term "producer", they left in the language "engaged in the business." They chose not to strike that out, and the owners of working interests may be considered as engaging in the business.

There is no way, as we see it, that the legislature contended that the owner of a mere royalty interest is considered to be engaging in the business. If the Court selected or if the legislature chose to cover both, there would have been absolutely no reason for putting in the words "engaged in the business." They could have simply said all producers and defining it with people who are entitled to receive money from a well as the legislature did and then strike out the "engaged in the business" but they chose instead to draw a line.

Shell would assume that line is not there, but the legislature selected those words and retained those words "engaged in the business" which would mean there are some people, some kinds of producers who don't have to pay the severance taxes because they are not engaged in the business.

Again, this Court cannot ignore those words. The legislature did not want those words ignored and the fact, as Mr. Smith avers without any evidence to support it, that it has been a standard practice adopted by the industry to impose severance taxes upon lessees or lessors, we submit that isn't

true. Indeed, there are many, many leases in which the lease specifically says that the lessor shall bear a share of the severance tax.

Now, if it was a standard practice in the industry, and the statute automatically made it a requirement that the lessor bear a share of the taxes, why the difference? We submit there is a difference and has a substance. The reason some lessees elect to put the language in their leases, that makes it crystal clear that the lessors bear a share of the severance taxes is because without the language they have no right to impose those severance taxes. Shell has not used that language in their leases.

At the time the leases were adopted and used, we submit that the law does not authorize Shell without the use of the words in their leases to impose a pro rata share of the severance taxes upon the lessors, unless the lessor is engaged in that business. That's a factual determination to be made on a case by case basis. We submit that because that factual determination cannot be made now, the case is not ready for summary judgment.

THE COURT: Mr. Smith, what's your answer again on Mr. Rosi's argument about this phrase "engaged in the business or severing from the soil?"

MR. SMITH: Your Honor, I think it is clear as a matter of statutory construction that a question came up when the Attorney General's opinion came down in 1963, and that logically, when they amended the statute in 1965, they were attempting to define those people who are subject to it.

Now, the fact that somebody is not out actually putting a hole in the ground doesn't mean they are not engaged in the business. They're receiving monetary rewards of it. They are actually involved in the severing, not physically, not located there, but they are part of this enterprise that is doing it, and to suggest otherwise simply ignores the facts, ignores what exists, and I think that legislature made it very clear. If they wanted to exclude a non-working interest

owner from having to pay anything, they simply could have done that, but they made it very clear when they talked about a producer that, indeed, it includes people like the Plaintiffs, and I don't think there can be any question about it as a matter of statutory construction and interpretation.

MR. ROSI: If I may respond briefly, your Honor?

THE COURT: Okay, fine.

MR. ROSI: If I lease my forty acres to a shopping center, by the fact that I am receiving rental payments from the shopping center developer does not make me in the business of renting a shopping center. If I lease my land, my mineral rights, to an oil company who selects or elects to drill a hole on my property, hopefully getting some oil and gas, does not put me in the business of severing oil and gas from the property, and I think Mr. Smith's suggestion is absurd.

These are leases. These are not partnership agreements. By the lease, the oil company has a right to go on the property and look around and see if it can find some oil. The lessor has no rights to engage in the business, to second guess, to tell the oil company where to drill, when to drill, how to drill, who to use, make any decisions regarding the business, and to suggest that because we are a lessor under a lease that we are in the business. We think that is absurd.

MR. SMITH: Just one point, your Honor. I frankly resent the fact that it might be characterized as being absurd. I would suggest to you that through Mr. Rosi's own example, if you were to lease land that became a shopping center, and you were to receive rentals based upon sales that, in fact, you would be engaged in a business, and it would be not that you were in the fact of selling something, but you would have a business that would be remunerated on that particular business.

Likewise, when you have a right to receive royalties, either in kind or as proceeds, you are engaged as defined as

a producer under the act and I think it is interesting to note that the way we define producer is one who has a right to a share of the monetary proceeds or a right to receive in kind, and that is precisely what we are dealing with here.

THE COURT: That is a phrase that bothers me. All right, both of you have advised me that you cannot find any cases exactly on point, and I have tried to research it on my own, and I have not been able to find any cases squarely on point, so I would assume it is a question of first impression for this Court.

Let me take a minute and read these three other articles that you have given me and I will be back with you.

(WHEREUPON A SHORT RECESS WAS HAD)

THE COURT: All right. During the brief recess, the Court has had an opportunity to review this additional material that has been given to me.

The law is clear that on a motion for summary judgment made pursuant to GCR 1963 117.2(1), that motion is to be tested by the pleadings alone. In examining those pleadings, the Court must accept as true the well-pleaded facts contained therein. The test is whether the Plaintiff's complaint on the pleadings is so clearly unenforceable as a matter of law that the factual development can possibly justify the right to recovery. In the resolution of a legal issue may depend greatly upon the factual content, the summary judgment on the pleadings is never proper.

Now, in regards to the Defendant's motion for partial summary judgment, this Court is called upon to interpret basically Section One and Section 12(2) of the Act. It is conceded by both sides that we do not have any appellate assistance or help in this matter. There is no argument that the definition contained in Section 12(2), the definition concerning a producer who is last in time as far as the historical development of the Statute. The Court is of the opinion and so finds that the definition is, in fact, broad enough to encompass or include the Plaintiffs in this particular action,

and I do so, fully recognize Mr. Rosi's argument on Paragraph Twenty-Nine of the amended complaint where the Plaintiffs allege that they are not engaged in the business of severing from the soil and oil and gas, but if the Court's ruling is correct, the definition is broad enough to encompass the Plaintiffs, then the mere fact that alleging that they are not, simply does not fill the bill.

The legislature has given some definition that says that you are engaged if you are part of that definition, so I am satisfied that isn't any factual issue that has to be determined. I am finding that as a matter of law, the definition does, in fact, encompass the Plaintiffs, and having so found, then the Court concludes that the motion for partial summary judgment is granted.

As we discussed in Chambers, I think we want to take a short recess at this point in time to decide where were want to go from this point forward. I guess my only suggestion is that it is obvious that you are calling upon me to interpret this section of the statute and I would feel much more confortable about it if you got an appellate opinion indicating whether that decision is correct, and it would appear to me that it would save a lot of time if we had either a reversal or affirmance of that decision. I'll leave that up to the two of you to discuss, so why don't we take a break for about ten minutes.

MR. SMITH: Thank you, Judge. I will prepare an appropriate order.

(WHEREUPON A SHORT RECESS WAS HAD)

DENIAL BY MICHIGAN COURT OF APPEALS OF PETITION FOR REHEARING

AT A SESSION OF THE COURT OF APPEALS OF THE STATE OF MICHIGAN, Held at the Court of Appeals in the City of Lansing, on the 4th day of November in the year of our Lord one thousand nine hundred and eighty-three.

Present the Honorable
Donald E. Holbrook, Jr.
Presiding Judge
Harold Hood
Timothy M. Green
Judges

No. 63011
L.C. No. 81-1151-CK

ALBERT K. BROWN, CATHERINE D. BROWN, KENT ROSENBERG, ARLENE ROSENBERG, VICTOR SCHULER, ELIZABETH SCHULER, DONALD E. WOOD, ELLEN L. WOOD, EARL HILLIARD, MARGARET HILLIARD, JEROME A. RAY, KAREN M. RAY, KENNETH R. HILLIARD, JO HANNAH A. HILLIARD, DONALD A. LONGFIELD, SYLVIA HILLIARD, CAROLYN M. WEBBER, ELI HILLIARD, MARGARET L. HILLIARD, GEORGE LEWIS, SONJA SUE LEWIS, MATT KOLB, BERTHA T. KOLB, FRANCIS LATUSZEK, MARY J. LATUSZEK, JAMES F. LAWNICHAK, ROBERTA H. LAWNICHAK, CHARLES V. HOUSE and MARYETTA J. HOUSE,
Plaintiffs-Appellants,

v

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

In this cause an application for rehearing is filed by plaintiffs-appellants, and an answer in opposition thereto having been filed, and due consideration thereof having been had by the Court,

Denial By Michigan Court of Appeals of Petition For Rehearing

IT IS ORDERED that the application for rehearing be, and the same is hereby DENIED for lack of merit in the grounds presented.

STATE OF MICHIGAN—ss.

I, Ronald L. Dzierbicki, Clerk of the Court of Appeals of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Court of Appeals at Lansing, this 8th day of November in the year of our Lord one thousand nine hundred and eighty three.

(s) Ronald L. Dzierbicki
Chief Clerk

Order of Michigan Supreme Court Holding Application for Leave to Appeal in Abeyance

ORDER OF MICHIGAN SUPREME COURT HOLDING APPLICATION FOR LEAVE TO APPEAL IN ABEYANCE

AT A SESSION OF THE SUPREME COURT OF THE STATE OF MICHIGAN, Held at the Supreme Court Room, in the City of Lansing, on the 22nd day of June in the year of our Lord one thousand nine hundred and eighty-four.

Present the Honorable
G. MENNEN WILLIAMS,
Chief Justice
THOMAS GILES KAVANAGH,
73097 CHARLES L. LEVIN,
JAMES L. RYAN,
JAMES H. BRICKLEY,
MICHAEL F. CAVANAGH,
PATRICIA J. BOYLE,
Associate Justices.

ALBERT K. BROWN, et al,
Plaintiffs-Appellants,

v

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

SC: 73097
COA: 63011 (128 MA 111)
LC: 81-8858-CK

On order of the Court, the application for leave to appeal is considered and, it appearing to this Court that the case of *Mobil Oil Co* v *Dep't of Treasury* (Docket No. 70388), leave granted December 6, 1983, is presently pending on appeal before this Court and that the decision in that case may be decisive of an issue raised in the present application for leave to appeal, it is ORDERED that the present application be held in abeyance pending decision in *Mobil Oil Co* v *Dep't of Treasury*.

Order of Michigan Supreme Court Holding Application for Leave to Appeal in Abeyance

STATE OF MICHIGAN—ss.

I, CORBIN R. DAVIS, Clerk of the Supreme Court of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Supreme Court at Lansing, this 22nd day of June in the year of our Lord one thousand nine hundred and eighty-four.

[SEAL]

(s) Corbin R. Davis
Clerk

Order of Michigan Supreme Court Denying Application for Leave to Appeal

ORDER OF MICHIGAN SUPREME COURT DENYING APPLICATION FOR LEAVE TO APPEAL

AT A SESSION OF THE SUPREME COURT OF THE STATE OF MICHIGAN, Held at the Supreme Court Room, in the City of Lansing, on the 15th day of January in the year of our Lord one thousand nine hundred and eighty-six.

Present the Honorable
G. MENNEN WILLIAMS,
Chief Justice
CHARLES L. LEVIN,
73097 JAMES H. BRICKLEY,
MICHAEL F. CAVANAGH,
PATRICIA J. BOYLE,
DOROTHY COMSTOCK RILEY,
DENNIS W. ARCHER,
Associate Justices.

ALBERT K. BROWN, et al,
Plaintiffs-Appellants,

v

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

SC: 73097
COA: 63011
LC: 81-8858-CK

By order of June 22, 1984, the application for leave to appeal was held in abeyance pending the decision in *Mobil Oil Co* v *Dep't of Treasury* (Docket No. 70388). On order of the Court, the decision having been issued on September 6, 1985, 422 Mich 473, the application is again considered, and it is DENIED, because we are not persuaded that the questions presented should be reviewed by this Court.

Order of Michigan Supreme Court Denying Application for Leave to Appeal

STATE OF MICHIGAN—ss.

I, CORBIN R. DAVIS, Clerk of the Supreme Court of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Supreme Court at Lansing, this 15th day of January in the year of our Lord one thousand nine hundred and eighty-six.

[SEAL]

(s) Corbin R. Davis
Clerk

Order of Michigan Supreme Court Denying Application for Reconsideration of Denial of Leave to Appeal

ORDER OF MICHIGAN SUPREME COURT DENYING APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

AT A SESSION OF THE SUPREME COURT OF THE STATE OF MICHIGAN, Held at the Supreme Court Room, in the City of Lansing, on the 29th day of April in the year of our Lord one thousand nine hundred and eighty-six.

Present the Honorable
G. MENNEN WILLIAMS,
Chief Justice
CHARLES L. LEVIN,
73097(44) JAMES H. BRICKLEY,
MICHAEL F. CAVANAGH,
PATRICIA J. BOYLE,
DOROTHY COMSTOCK RILEY,
DENNIS W. ARCHER,
Associate Justices.

ALBERT K. BROWN, et al.,
Plaintiffs-Appellants,

v

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

SC: 73097
COA: 63011
LC: 81-8858-CK

On order of the Court, the motion for reconsideration of this Court's order of January 15, 1986, is considered, and it is DENIED, because it does not appear that the order was entered erroneously.

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Order of Michigan Supreme Court Denying Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN—ss.

I, CORBIN R. DAVIS, Clerk of the Supreme Court of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Supreme Court at Lansing, this 29th day of April in the year of our Lord one thousand nine hundred and eighty-six.

[SEAL]

(s) Jacqueline B. MacKinnon
Deputy Clerk

Order of United States Supreme Court Extending Time to File a Petition for Writ of Certiorari to June 13, 1986

SUPREME COURT OF THE UNITED STATES

No. A-771

ALBERT K. BROWN, ET AL.,
Applicants

v.

SHELL OIL COMPANY

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for the applicants,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 13, 1986.

/s/ Sandra D. O'Connor
Associate Justice of the Supreme Court of the United States

Dated this 14th
day of April, 1986.

APPENDIX B

APPENDIX B

MICHIGAN ATTORNEY GENERAL OPINIONS

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Opinion of Attorney General 1961-'62 No. 4010

OPINION OF ATTORNEY GENERAL
1961-'62 No. 4010

BIENNIAL REPORT

of the

ATTORNEY GENERAL

of the

STATE OF MICHIGAN

for the

BIENNIAL REPORT ENDING DECEMBER 31, 1962

FRANK J. KELLEY
ATTORNEY GENERAL

BY AUTHORITY

SPEAKER-HINES AND THOMAS, INC., LANSING, MICH.—1963

Opinion of Attorney General 1961-'62 No. 4010

OIL AND GAS: Severance Tax.
TAXATION: Specific, Severance.

The Michigan severance tax subjects the privilege of oil and gas extraction to specific taxation and the person performing the privilege is not exempt therefrom by reason of performing the severance upon land owned by the Federal, state or local government, Indians or charitable, educational or other public welfare organizations.

The base of the Michigan severance tax is the market price of the oil or gas at the place and time of its severance. If there exists no posted well-head price at the place of severance, the market price of oil is to be determined by making a compensating adjustment for transportation expense to the market price of such oil at the pipeline receiving station or other gathering point.

No. 4010 November 14, 1962.

Mr. Donovan J. Rau, Deputy Commissioner
Michigan Department of Revenue
Lansing, Michigan

You have requested the opinion of this office upon questions dealing with the scope and measure of the tax imposed by Act No. 48, P.A. 1929.[1] Said act levies

> "* * * upon each corporation, association, or person engaged in the business of severing from the soil oil or gas, a specific tax to be known as the severance tax. * * *"

Section 3 of Act No. 48, P.A. 1929,[2] provides that the severance tax

> "* * * shall be in the amount of two (2) per cent of the gross cash market value of the total production of such oil or gas during the preceding monthly period. The value of all such production shall be computed as of the time when and at the place where the same have been severed or taken from the soil immediately after such severance * * *"

You specifically request answers to the following questions:

1. Are certain corporations, associations or persons engaged in the business of severing oil and gas from the soil exempt from the specific tax known as the severance tax by virtue of the fact that the soil from which the oil or gas is extracted is owned by the Federal government, state or local government, Indians, charitable, educational or other public welfare organizations?

2. If there is no established market price at the place where oil is severed or taken from the soil, may a market price be established by making a compensating adjustment for transportation expenses to the established market price of such oil at the pipeline receiving station or other gathering point?

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[1] C.L. '48, § 205.301, et seq.; M.S.A. § 7.351, et seq.
[2] C.L. '48, § 205.301; M.S.A. § 7.351.
[3] C.L. 48' § 205.303; M.S.A. § 7.353.

Opinion of Attorney General 1961-'62 No. 4010

The questions you have propounded have been the subject matter of two opinions by the Attorney General in the year 1929.[4] The opinion issued on October 16, 1929, relied upon the concept of derivative intergovernmental tax immunity which was announced as the law of the country in several United States Supreme Court cases during the first three decades of the twentieth century.[5] Pursuant to these cases, it was held that a private person engaging in an active privilege upon Federal property could insist upon tax immunity, having derived such immunity from the Federal government by privity.

The cases relied upon in the aforesaid Attorney General's opinions have been expressly overruled by

Oklahoma Tax Comm'n. v. *Texas Co.*, 336 U.S. 342, 69 S Ct. 561 (1948),

which held that the lessee of mineral rights in allotted and restricted Indian lands was no longer entitled to derivative tax immunity.[6]

The Michigan severance tax is imposed upon producers and extractors of oil and gas. It is a specific privilege tax as distinguished from a property tax. Its incidence is upon the act of severance.

A state is prohibited from taxing lands owned by the Federal government, or its wards, such as Indians of the several tribes, without congressional consent. However, since the decision in the *Oklahoma Tax Commission* case, *supra*, there can be no question that an act performed as a legal privilege upon such land by private persons may be subjected to taxation. It follows, therefore, that the holding of the Attorney General's opinion of October 16, 1929, is no longer sound and, therefore, is overruled.

The Michigan Severance Tax Act contains no exclusions or exemptions. Consequently, the privilege of severance by a private person is subject to taxation when such privilege is performed upon Federal or Indian lands. Since the producer of oil and gas from lands of the state, or local governments, charitable, educational or other welfare organizations is to be treated in the same manner as the producer upon Federal and Indian lands,[7] he, likewise, must be subjected to the severance tax.

The first question you have propounded is, therefore, answered in the negative.

The second question submitted for answer requires determination of the statutory tax base. Section 3 of the Severance Tax Act states that the tax base shall be

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[4] O.A.G., 1928-1930, August 12, 1929, p. 531; O.A.G., 1928-1930, October 16, 1929, p. 627.

[5] *Choctaw, O. & G. R. Co. v. Harrison*, 235 U.S. 292, 59 L. ed. 234, 35 S Ct. Rep. 27; *Indian Territory Illuminating Oil Co. v. Oklahoma*, 240 U.S. 522, 60 L. ed. 779, 36 S Ct. Rep. 453; *Howard v. Gypsy Oil Co.*, 247 U.S. 503, 62 L. ed. 1239, 38 S Ct. Rep. 425; *Large Oil Co. v. Howard*, 248 U.S. 549, 63 L. ed. 416, 39 S Ct. Rep. 183; *Gillespie v. Oklahoma*, 257 U.S. 501, 66 L. ed. 338, 42 S Ct. Rep. 177; *Oklahoma v. Barnsdall Refineries*, 296 U.S. 521.

[6] The *Oklahoma Tax Commission* case, *supra*, was the last of a series of cases denying tax immunity claimed by derivation from the Federal government.

[7] *Phillips Chemical Co. v. Dumas Independent Sch. Dist.*, 361 U.S. 376 (1960), requires the conclusion expressed.

> "• • • the gross cash market value of the total production • • • as of the time when and at the place where the same have been severed or taken from the soil immediately after such severance. • • •"

The term "gross cash market value" constitutes a misnomer and, to our knowledge, has not been utilized in any other statute of either this or any other state. Cash market value represents a fixed amount of legal tender, unaffected in substance by redundant characterization as *gross* or *net*.

The term "cash market value" has been judicially recognized to be the equivalent of the term "market value", and indicates merely that the latter is generally expressed in terms of cash.[8]

The latter term is synonymous with "market price".[9]

The Texas court defines the phrase "market value", as used in the Texas statute imposing a severance tax on producers of natural gas, to mean "the price" for which the producer sells the gas.

> *Calvert* v. *Union Producing Co.*, Tex. Civ. App., 269 S.W. 2d 525, 526.

Having determined that the base of the Michigan severance tax is the market price of the oil and gas, it becomes necessary that we consult the statute to determine the identity and location of the market. The statute specifies that the tax base shall be "as of the time when and at the place where" the gas or oil has been severed. Consequently, the statute contemplates as many "markets" as there are locations at which severance occurs.

The syllabus of the Attorney General's opinion rendered on August 12, 1929, states that the privilege of oil severance "shall be taxed on the gross value at the well". The last sentence of the opinion reads:

> "It is my opinion that this tax should be paid on the gross market value of the oil at the well without any deduction for handling, transportation or foreign exchange."

Had the last sentence terminated after the word "well", the opinion would clearly be entitled to our unqualified support. Addition of the phrase "without any deduction for handling, transportation or foreign exchange", however, injects an ambiguity.[10]

For the majority of oil fields and well locations in Michigan, there exists a posted wellhead price. Obviously, this establishes the market value and

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[8] *Hetland* v. *Bilstad*, 118 N.W. 422, 423, 140 Iowa 411; *Housing Authority of Birmingham Dist.* v. *Title Guarantee Loan & Trust Co.*, 8 So. 2d 835, 837, 243 Ala. 157; *Senters* v. *State*, 291 S.W. 2d 739, 740, 163 Tex. Cr. R. 423.

[9] *National Folding Box Co.* v. *City of New Haven*, 153 A. 2d 420, 424, 146 Conn. 578; *Kansas City Star Co.* v. *Wisconsin Dept. of Taxation*, 99 N.W. 2d 718 723, 724, 8 Wis. 2d 441; *Dickinson* v. *Fire Ass'n. of Philadelphia*, 106 A 2d 607, 610, 378 Pa. 396.

[10] It should perhaps be noted that charges for exchanging foreign currency into legal tender of the United States, or vice versa, are never an element in the price of a product sold by a person in one country to a person in another country. Such charges are the consideration requested and received by the person who performs the service of currency exchange and do not affect the price of the product.

the severance tax is easily determined by applying the rate of the tax against such price. At some marginal and remote oil wells, there does not exist, however, a predetermined wellhead price for the oil severed. The second question you have posed relates to the problem of determining the base of the tax upon the privilege of oil severance at the latter type of well locations.

The Revenue Department of the State of Texas[n] has recognized the occasional complexity of determining the market price of oil at the place of its severance and will permit deduction of reasonable charges for hauling oil from the gathering point in order to establish a market price of the oil at the well. In

> *Cumberland Pipe Line Co. v. Commonwealth*, 15 S.W. 2d 280, 284, 228 Ky. 453,

the court equates the "market value" of a commodity to its usual selling price in the usual and ordinary course of business. The court further holds that if there be no market at the particular place at which it is determined to fix market value, the market value is established by making downward adjustments to the commodity's price at the nearest market to compensate for the cost of transportation to that market.

The view of the Kentucky court appears eminently logical and is consistent with economic theory which holds that transportation from the point of origination to a market augments the value of a commodity, and that the increment of added value conferred upon the commodity by the transportation is reflected in the higher price it commands at the market place.

It is, therefore, concluded that the answer to your second question must be in the affirmative.

FRANK J. KELLEY,
Attorney General.

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[n] See the letter of February 5, 1952, from the Comptroller of Public Accounts to Commerce Clearing House, Inc., State Tax Reporter, Texas, paragraph 45-031.09.

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Opinion of Attorney General 196[illegible] '64 No. 4160

OPINION OF ATTORNEY GENERAL
1963-'64 No. 4160
BIENNIAL REPORT

of the

ATTORNEY GENERAL

of the

STATE OF MICHIGAN

for the

BIENNIAL PERIOD ENDING DECEMBER 31, 1964

FRANK J. KELLEY
ATTORNEY GENERAL

AUTHORITY

SPEAKER-HINES AND THOMAS, INC., LANSING, MICHIGAN—1965

Opinion of Attorney General 1963-'64 No. 4160

CONSERVATION DEPARTMENT: Oil and Gas Leases.
OIL AND GAS: Severance and Privilege Taxes.
LEASES: Shifting of Tax Burden.
TAXATION: Severance and Privilege Taxes.

State of Michigan Conservation Department oil and gas leases make no provision for shifting of the tax burden as to severance and privilege taxes to the State for the ⅛ of the oil specified as royalty.

Severance and privilege taxes are the primary liability of the producers of oil and they must pay these taxes on the entire amount of the oil produced and may not deduct ⅛ of these taxes from the State's royalty in the absence of statutory authority.

A division order cannot make the State of Michigan liable for severance and privilege taxes when these, by statute, are made the primary responsibility of the producer.

The State of Michigan is entitled to receive full ⅛ royalty under its lease without deduction for any taxes.

No. 4160 June 17, 1963.

Mr. Gerald E. Eddy, Director
Department of Conservation
Mason Building
Lansing, Michigan

This is in response to your letter of March 13, 1963. You indicate that questions have been raised by State auditors concerning the State's royalty interest in oil and gas under State leases. The questions concern the industry practice of withholding a severance tax of 2% of the gross cash market value of the product[1] and of a privilege tax of ⅛ of 1¢ per barrel of crude oil[2] from proceeds paid to the State. You ask whether these taxes are rightfully imposed on the State's proportionate share of all oil and gas produced and sold, and as to the legality of imposing a tax on the State's share of production.

Enclosures submitted are State of Michigan lease form and Division Order form.

Act 48, P.A. 1929, Sec. 1,[3] provides in part as follows:

> "There is hereby levied upon each corporation, association, or person engaged in the business of severing from the soil oil or gas, a specific tax to be known as the severance tax. * * *"

It would appear from the above quoted statute that the producer or the party engaged in withdrawing the oil and separating it from the ground is the party upon whom the severance tax is levied. In other words, this is a specific tax.

Section 3[4] of the act provides in part:

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[1] Act 48, P.A. 1929, M.S.A. Sec. 7.351, C.L. 1948, Sec. 205.301 et seq.
[2] Act 61, P.A. 1939, as amended, M.S.A. Sec. 13.139(22), C.L. 1948, Sec. 319.22.
[3] C.L. 1948, Sec. 205.301 et seq.; M.S.A. 7.351.
[4] M.S.A. 7.353; '48 C.L. 205.303.

"The severance tax required to be paid by each producer at the time of rendering each monthly report, or by any pipe line company, common carrier or common purchaser, for and on behalf of any such producer, shall be in the amount of two (2) per cent of the gross cash market value of the total production of such oil or gas during the preceding monthly period. The value of all such production shall be computed as of the time when and at the place where the same have been severed or taken from the soil immediately after such severance. Except as otherwise provided in this section, the payment of said severance tax shall be required of the severor or producer actually engaged in the operation of severing the oil or gas. * * *"

A privilege tax is imposed by Act 61, P.A. 1939[5] and provides as follows:

"A privilege fee of one-eighth (⅛) of 1 cent per barrel shall be paid upon oil produced in Michigan and sold. This fee shall be levied and collected by the Michigan tax commission in the same manner as provided in and by Act No. 48 of the Public Acts of 1929, of the state of Michigan. All moneys received from this source shall be turned in to the general fund of the state."

We will first consider the industry practice of withholding a severance tax of the gross cash market value of the product. Our research discloses that a number of oil and gas producing States have enacted statutes levying production, severing, occupation, privilege and distribution taxes on gross productions of oil and gas. Examination of the work entitled "Summers on Oil and Gas," Section 801, page 410 indicates that the practice varies as to who bears the tax and he says as follows:

"* * * In some states the burden of the tax is borne by the lessee and royalty owner proportionately, but in others it is borne by the lessee or producer alone. In some states such taxes are in lieu of property taxes, but in others they are additional taxes."

The Michigan acts levying the severance and privilege taxes have not been judicially construed.

Examination of the State of Michigan lease furnishes no indication that the taxes imposed by the above statute are to be borne by the State of Michigan. The State of Michigan lease makes the following provisions for payment of royalty:

"F(1a) To deliver to the credit of the Lessor herein, free of cost in tank car, or pipe line to which Lessee may connect its well or wells, the equal one-eighth part of all oil produced and saved from the leased premises described above and listed in Schedule _____, or at the option of the Lessor, Lessee shall pay the value thereof in cash at the prevailing market price of oil of same grade and quality at that time and place.

"(2) Should gas and oil both be found in any well, the Lessee shall pay to the Lessor for gas produced and sold from any such oil well, as royalty, one-eighth of the value thereof in cash at the prevailing market price in the field where produced. If such gas is used by the Lessee for

[5] C.L. 1948, Sec. 319.22; M.S.A. 13.139(22).

> the production of casinghead gasoline, the royalty shall be one-eighth of the gross proceeds received from the sale of such casinghead gasoline and one-eighth of the gross proceeds received from the sale of gas from which the casinghead gasoline has been extracted; provided further that the Lessor shall receive as royalty one-eighth of the gross proceeds of the sale of drip gasoline and natural gasoline recovered from the gas produced from leased premises."

No arrangement is made in any of the clauses contained in the lease for the shifting of the tax burden on the ⅛ royalty interest of the State.

You have furnished us with a copy of a typical Division Order entered into by an oil company and the Department of Conservation. This Division Order makes a provision for payment of taxes in paragraph 6 which reads as follows:

> "6. You are hereby authorized at your election to withhold from the proceeds accruing hereunder to any of the undersigned the amount of any severance, production, occupation or other tax levied against him by or under authority of the laws of the United States and of the State of Michigan for and on account of his interest in said oil, land or lease and to pay such tax or taxes with the withheld proceeds."

We do not consider that this Division Order can impose any tax liability where none exists. A Division Order is entered into for the purpose of separating the various interests and to determine how payments shall be made in satisfaction of royalties. The agreement between the Lessor and Lessee is contained in the lease and determines the various liabilities. A lease is not affected by the Division Order. *Stanolind Oil & Gas Co. v. Terrell,* (Tex.), 183 S.W. 2d 743.

Under the Michigan acts, the privilege tax is imposed upon the severor or producer. There is authority to the effect that by statute or by agreement the shifting of this tax can be made to the Lessor. However, that is not the situation here. The lease with the State of Michigan does not provide for the assumption of the tax burden by the State of Michigan and if it did, such a provision would be invalid in the absence of statutes permitting the same.

The General Property Tax Law provides in part:[6]

> "Property exempt from taxation.] Sec. 7. The following property shall be exempt from taxation:
>
> * * *
>
> State property.] Second, All public property belonging to the state of Michigan, except licensed homestead lands, part-paid lands held under certificates, and lands purchased at tax sales, and still held by the state;"

In the case of *Ryerson v. Township of Laketon,*[7] it is stated:

> "When a tax is levied for any purpose, it must have express warrant of law to authorize its imposition."

[6] M.S.A. § 7.7; 1948 C.L. § 211.7.

[7] 52 Mich. 509, 517.

and in *People v. Ingalls*,[8] it is stated:

> "The doctrine has been pretty well settled in this State and elsewhere that property owned by the State or by the United States is not subject to taxation unless so provided by positive legislation. * * *"

I am of the opinion that the State's ⅛ royalty interest is due and payable to the State of Michigan without any withholding for severance or privilege taxes.

FRANK J. KELLEY,
Attorney General.

LEGISLATURE: Members di qualified as candidates for other state offices.

CONSTITUTIONAL LAW: Legislators disqualified as candidates for other state offices.

A member of the legislature is prohibited by Article IV, Section 9, of the 1963 Constitution from receiving an appointment, and is disqualified from election to another state office, the term of which is to commence during his term of office as a member of the legislature. Such prohibition or disqualification is not applicable to a local office.

No. 4169 June 17, 1963.

Honorable Joseph A. Gillis
State Representative
2312 Guardian Building
Detroit 26, Michigan

Your letter cites Article IV, Section 9, of the Revised Constitution, and requests my opinion on the following question:

> "May a member of the Legislature run for another State or Local Office while serving in the Legislature under the revised Constitution?"

Reference will first be made to the predecessor of such section in the 1908 Constitution, i.e., Article V, Section 7, which read in part:

> "No person elected a member of the legislature shall receive any civil appointment within this state or to the senate of the United States from the governor, except notaries public, or from the governor and senate, from the legislature, or any other state authority, during the term for which he is elected. All such appointments and all votes given for any person so elected for any such office or appointment shall be void. * * *"

The corresponding provision of the 1850 Constitution, i.e., Article IV, Section 18, read practically the same, aside from the exception inserted in the 1908 section relating to notaries public.

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[8] 238 Mich. 423, 425. See also: *Wyandotte v. State Board*, 278 Mich. 47; O.A.G. 1959-1960, Vol. 1, pp. 201, 202, No. 3437; O.A.G. 1961-1962, pp. 597, 598, No. 4095.

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APPENDIX C

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STATE OF MICHIGAN
IN THE COURT OF APPEALS

ALBERT K. BROWN, CATHERINE D. BROWN, KENT ROSENBERG, ARLENE ROSENBERG, VICTOR SCHULER, ELIZABETH SCHULER, DONALD E. WOOD, ELLEN L. WOOD, EARL HILLIARD, MARGARET HILLIARD, JEROME A. RAY, KAREN M. RAY, KENNETH R. HILLIARD, JO HANNAH A. HILLIARD, DONALD A. LONGFIELD, SYLVIA D. LONGFIELD, ERNEST C. HILLIARD, BETTY L. HILLIARD, CAROLYN M. WEBBER, ELI HILLIARD, MARGARET L. HILLIARD, GEORGE LEWIS, SONJA SUE LEWIS, MATT KOLB, BERTHA T. KOLB, FRANCIS LATUSZEK, MARY J. LATUSZEK, JAMES F. LAWNICHAK, ROBERTA H. LAWNICHAK, CHARLES V. HOUSE and MARYETTA J. HOUSE,

Plaintiffs - Appellants,

v

SHELL OIL COMPANY, a Delaware Corporation,

Defendant - Appellee

COURT OF APPEALS NO. 63011-G

GRAND TRAVERSE CIRCUIT COURT NO. 81-8858-CK

BRIEF OF APPELLANTS

ORAL ARGUMENT REQUESTED

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DATED: July 14, 1982

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STATEMENT OF FACTS

Plaintiffs-Appellants are holders of simple royalty interests in wells owned and operated by Defendant-Appellee Shell Oil Company, pursuant to diverse oil and gas leases. Shell Oil Company deducts from royalties payable to plaintiffs a portion of the Severance Tax imposed upon "Producers engaged in the business of severing from the soil, oil and gas . . ." (MCLA 205.301, MSA 7.351). No authority for this practice exists in the oil and gas leases and plaintiffs have brought suit in Grand Traverse County Circuit Court to challenge this and other of Shell's practices.

Shell Oil Company moved for Partial Summary Judgment pursuant to GCR 117.2(1) on the grounds that plaintiffs had failed to state a claim upon which relief could be granted. Judge Charles M. Forster, in making his ruling on Shell's Motion, specifically noted:

1. That plaintiffs, in Paragraph 29 of their Complaint, had alleged that they were not engaged in the business of severing oil and gas from the soil and

2. that there were no existing Michigan Court decisions on point to guide him.

Nonetheless, he granted Shell's Motion for Partial Summary Judgment, inviting the parties to appeal his decision.

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STATEMENT OF QUESTIONS INVOLVED

1. Does the Michigan Severance Tax Statute (MCLA 205.301 et seq.; MSA 7.351 et seq.) obligate a person, whose sole interest in an oil or gas well is a royalty interest, to bear a portion of the Severance Tax?

The Court below answered ..... Yes

Appellants' answer ..... No

2. Does the allegation in plaintiffs' Amended Complaint that plaintiffs are not engaged in the business of severing from the soil, oil and gas, raise a factual issue sufficient to bar a Motion for Summary Judgment under Rule 117.2(1) GCR, 1963?

The Court below answered ..... No

Appellants' answer ..... Yes

ARGUMENT

In this action, Appellants (plaintiffs below) have alleged that Appellee, Shell Oil Company, is improperly deducting from their royalty checks a pro rata share of Michigan's Severance Tax on oil and gas. Shell Oil Company, on the other hand, takes the position that owners of royalty interests are obligated, under the Severance Tax Statute, to bear a portion of said Tax. The question is simply one of statutory interpretation.

The Severance Tax Statute reads:

> There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax. (MCLA 205.301, Sec. 1; MSA 7.351)

Section 12(2) of the Act defines Producer:

> "Producer" as used in this act means a person who owns, or is entitled to a share in kind or a share of the monetary proceeds from the sale of gas or oil as of the time of its production or severance. (MCLA 205.301; MSA 7.362)

Judge Forster correctly recognized that Shell's Motion for Summary Judgment was to be considered on the pleadings alone:

> "The law is clear that on a motion for summary judgment made pursuant to GCR 1962 117.2(1), that motion is to be tested by the pleadings alone. In examining those pleadings, the Court must accept as true the well-pleaded facts contained therein. The test is whether the Plaintiff's complaint on the pleadings is so clearly unenforceable as a matter of law that [no] factual development can possibly justify the right to recovery. [If] the resolution of a legal issue may depend greatly upon the factual content, the summary judgment on the pleadings

> is never proper." [Tr. Page 13] [See *Ken Cowden Chevrolet* v *Corts*, 112 Mich App 570, 572 (1982)]

Then, apparently reversing himself, Judge Forster, while acknowledging the specific allegations in Paragraph 29 of plaintiffs' Amended Complaint, to wit:

> "29. That plaintiffs are not engaged in the business of severing from the soil, oil or gas."

ruled that that allegation "simply does not fill the bill" (Tr. 14) since, in his view, plaintiffs fall within the statutory definition of "Producer":

> "The Court is of the opinion and so finds that the definition [of Producer] is, in fact, broad enough to encompass or include the Plaintiffs in this particular action, and I do so, fully recognizing Mr. Rosi's argument on paragraph 29 of the amended complaint where the Plaintiffs alleged that they are not engaged in the business of severing from the soil oil and gas, but if the Court's ruling is correct, the definition is broad enough to enough to encompass the Plaintiffs, then the mere fact alleging that they are not, simple does not fill the bill." (March 3, 1982, Hearing, Page 14)

It is crucial to a proper determination of this matter to note that the Trial Court's and Shell's construction of the statute in question renders the phrase "engaged in the business of severing" totally meaningless. The Trial Court, without any *factual* basis whatsoever, determined that the various royalty owners who are the appellants herein are "producers engaged in the business". Therefore, under the Trial Court's construction, all royalty owners must be "producers engaged in the business". Inasmuch as the statutory definiton of the word "producer" arguably includes royalty owners, the Trial Court's construction mandates that the phrase "engaged in the business" could be removed from the statute without changing the result.

It is impossible to evaluate Judge Forster's decision without examining the history of the Severance Tax Statute. The Tax was initially enacted in 1929 as Public Act P.A. #48:

> "There is hereby levied upon each corporation, association, or person engaged in the business of severing from the soil oil or gas, a specific tax to be known as the severance tax."

The 1929 statute defined "person" as any person, firm, concern, receiver, receivers, trustee, executor, administrator, agent, institution, association, partnership, company, corporations and persons acting under declaration of trust. Under a literal reading of that statute, persons with no monetary interest related to actual production, but who were engaged in the "business" of severing oil and gas from the soil, would be subject to the severance tax. Such persons would include contract well drillers, material suppliers, seismographic companies and others generally participating in the oil and gas business.

In 1965, the statute was amended. The word "Producer" was substituted for the words "corporation, association or person." At the same time, the term "Producer" was given its present definition. Shell Oil Company has asserted that this change in the law was precipitated by Attorney General's Opinion No. 4160 dated June 17, 1963 which, in examining the 1929 Act, found that the Severance Tax was a specific tax imposed upon the severor and that no portion of such tax could be passed on to the owner of royalty interest without a specific agreement in the oil and gas lease allowing such practice. Such a tax imposed on the severor constituted an Occupational Tax, an additional cost of doing business.

Shell argues that the Legislature's actions were intended to bring royalty owners into the category of persons or entities subject to the Severance Tax. However, there is nothing to support this position. Indeed, if royalty owners are, in fact, "engaged in the business" of severing oil and gas from the soil, as Shell now argues, they would already have been subject to the tax as "persons" so engaged under the 1929 statute.

It is more plausible to conclude that the 1965 amendment was to accomplish another purpose: namely to limit the scope of persons potentially subject to the tax to those who actually receive a portion of production of wells. The amendment removed any ambiguity in the first statute which included among persons "engaged in the business" persons not necessarily recipients of a share of production, such as well drillers, suppliers, seismic contractors and others, all as previously noted. The Legislature, by continuing to use the qualifying language "engaged in the business of severing from the soil oil and gas" intended to continue to limit the imposition of the Tax to those actually so engaged. If this were not so, the Legislature would either have:

1. deleted the language "engaged in the business of severing from the soil, oil or gas" as being redundant, or

2. applied its new definition of "Producer" to "Producer engaged in the business of severing from the soil oil or gas."

Is there any logic in concluding without more that a royalty owner is, *ipso facto* "engaged in the business"? The owner of a simple royalty interest in an oil or gas well is no more "engaged in the business" of severing oil and gas from the soil than the owner of one share of common stock of General Motors is "engaged in the business" of manufactur-

ing Cadillacs. A simple royalty owner has no right to participate in any business decisions concerning the well, its operation or the ultimate marketing of its products. Indeed, the owner of a share of common stock having the right to attend a shareholders' meeting as an owner of the corporation and to join with other owners to influence, if not change, management, has more rights than a simple royalty owner. Moreover, Shell Oil Company, in Paragraph 9 of its Answer to plaintiffs' Amended Complaint, denied "any inference that Plaintiffs own Defendant's wells located on Plaintiffs' premises."

Appellants have made an extensive search with the Legislative Service Bureau and the State Archivist in Lansing for any legislative history with respect to the Severance Tax Statute. None has been found.

In the absence of evidence of legislative intent, Appellants ask this Court to give effect to the plain language of the statute. The words "engaged in the business of severing from the soil oil or gas" cannot be ignored.

> "It is axiomatic that a court must enforce clear and ambiguous statutory provisions as written. A legislature is presumed to have intended the plain meeting of the words used by it. Correct and proper interpretation means giving effect to every word of the statute. Every effort must be made to avoid declaring any portion of the legislature's language to be mere surplusage." *People* v *Langhan*, 101 Mich App 391 (1980) (citations omitted)

> "Every word of a statute should be given meaning and no word should be treated as surplusage or rendered nugatory if at all posible." *Baker* v *General Motors Corp.*, 409 Mich 639 (1980)

In Attorney General's Opinion No. 4160 (1963) cited above, the words "engaged in the business of severing oil and gas" were not only *not* ignored but were determinative of the outcome.

The question of whether or not plaintiffs are "engaged" in the business of severing from the soil oil and gas is, plain and simple, a factual determination. Plaintiffs have alleged, in Paragraph 29 of their Amended Complaint, they are not so engaged. Defendant, in its answer to that Paragraph incorrectly asserts that the allegations are conclusions of law requiring no answer. A simple analysis of the words "engaged in the business" make obvious the factual question, and hence the incorrectness of defendant's position.

As mandated by the Legislature in its rules of construction

> "All words and phrases shall be construed and understood according to the common and approved usage of the language; but technical words and phrases, and such as may have acquired a peculiar and appropriate meaning in the law, shall be construed and understood according to such peculiar and appropriate meaning", MCLA 8.3a, MSA 212.1.

"Engaged", as defined by Webster means "occupied" or "employed". *Webster's New International Dictionary of the English Language*, Second Edition, Unabridged (1957), Volume 1, page 847. *Black's Law Dictionary*, Fourth Edition, 1957, page 622 notes that "Engaged" means to take part in or be employed in and denotes more than a single act or transaction or an occasional participation.

"Business", according to *Webster* is "that which busies, engages time, attention or labor, as a principal serious concern or interest. Specifically (a) Constant employment; regular occupation; work; as the *business* of living; *business* before pleasure (b) Any particular occupation or employment habitually engaged in, esp. for livelihood or gain". *Webster, supra*, page 362. *Black's Law Dictionary* notes that business has no definition or legal meaning but in the litany of examples cited, the term requires some active involve-

ment, more than single, occasional or isolated activities. *Black's Law Dictionary, supra*, pages 248 and 249.

Plaintiff's have alleged that they, and each of them, are not "engaged in the business". Whether they are "engaged in the business" necessarily requires evidence of the doings of each plaintiff and the related involvement of each plaintiff in severing oil and gas from the soil to ascertain whether any, or all of them, are so involved as to be "engaged in the business" within the common and approved usage of the English language. Judge Forster, in his Order for Partial Summary Judgment (Record G) by ruling that, as a matter of law, plaintiffs are "engaged in the business", made a factual determination that the pleaded allegation of plaintiffs that they were "not engaged in the business" was untrue. Making such a determination without any evidence whatsoever was clearly beyond the scope of Summary Judgment, for in passing upon a Motion for Summary Judgment, "liberality should be exercised in finding a genuine issue of material fact, and the benefit of any doubt should be given to the party opposing Summary Judgment". *Lipton* v *Boesky*, 110 Mich App 589, 598 (1981).

Appellants do not rely solely upon the simple interpretation of the English language, for the question of the interpretation of the Michigan law is not unique. Professor W.L. Summers, in Section 801 of his Treatise on oil and gas, in his discussion of state taxes on gas and oil production, specifically does not ignore the words "engaged in the business of severing oil and gas":

> "A number of oil and gas producing states levy taxes, the amounts of which are determined on the basis of the gross production of oil and gas during stated periods. They are called severance, production, occupational, gathering and distributing taxes. *They are not taxes on property, but on the business of severing, producing, gathering and distributing oil and gas.* In some states

> the burden of the tax is born by the lessee and royalty owner proportionately, but in others it is born by the lessee or producer alone. Summers, *The Law of Oil and Gas*, Sec. 801 (1962) (Emphasis supplied)

Professor Summers summarizes statutes from Arkansas, Florida, Alabama, Louisiana, Michigan, Mississippi, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, Texas and West Virginia.

A review of Summers' Treatise demonstrates that the statutes in the states of Arkansas, Florida, Alabama, Louisiana, Mississippi, Nebraska, New Mexico, North Dakota and Oklahoma contain specific provisions providing that the party actually severing the oil or gas from the land is required to pay the tax and is *specifically authorized* to withhold the share of the tax attributable to the royalty interest from royalty payments. Professor Summers notes that the Michigan statute contains no such provision and draws the following conclusion:

> "This Act (the Michigan statute) does not expressly state that a producer may deduct from the royalty payments the tax due from royalty oil or gas, *thus indicating the royalty owner bears no part of the tax burden.*" (Emphasis supplied)

Although the above language is found in the 1962 edition of Professor Summers' Treatise, prior to the 1965 statutory amendments, the determinative words "engaged in the business of severing from the soil, oil and gas" have not been changed, and Professor Summers, in post-1965 supplements to his Treatise has not altered his view of the Michigan statute.

A review of out-of-state severance taxes shows that, absent specific authorization for the severor to deduct the royalty owner's share of the tax, the tax does not extend to the royalty owner. In *Burbank* v *Sinclair Prairie Oil Co.*, 202

SW 2nd 420 (Ky 1946) the Court specifically addressed this issue, citing Professor Summers' Treatise, as well as his interpretation of the Michigan statute:

> "It is of interest and persuasion to note similar laws of other oil producing states and court rulings touching the question here discussed. In referring to these we give credit to Summers' Oil and Gas, Vol. 4, dealing with taxation of minerals. Arkansas, Louisiana, Michigan, Oklahoma, Mississippi, New Mexico and Texas have, and some have had prior to 1917, taxes on the production of oil. The tax, variously called, license, franchise, production, privilege or severance taxes. In each of those named the Legislature provided specifically that the tax should be borne by the producer or lessee and the royalty owner; the lessor in some being classified as a producer.
>
> Mr. Summers in reference to this character of taxation suggests that such tax in not a property tax but one 'upon the business of severing and producing oil. In some states the tax is borne by the lessee and royalty owner proportionately, but in others by the lessee or producer alone.' In referring to the Michigan law, a severance tax on all persons producing oil and gas, the author says: 'This Act does not expressly state that a producer may deduct from the royalty payments the tax due from royalty oil and gas, *thus indicating that the royalty owner bears no part of the tax burden.' Burbank, supra*, at 424 (Emphasis supplied)
>
> In Illinois the tax was on persons engaged in the business of producing oil, (occupation tax) and royalty owners were to bear a proportionate share. In *Ohio Oil Co.* v *Wright*, 386 Ill 206, 53 NE 2nd 966, the court held, notwithstanding the provision of the Act, that the effort to tax the royalty owner was illegal, because oil royalty owners are not engaged in the business of producing oil or gas, hence not subject to an occupation tax.

> *Without going into detail, we find that in other States having similar acts, and which do not define the word 'producer' or where the act does not make the lessor proportionately liable, the courts have held the tax not to extend. Kanawha Valley Bank* v *United Fuel Gas Co.*, 121 W. Va. 96, 1 SE 2nd 875. Prior to 1933 Texas law provided a tax on all who engaged in producing crude oil and did not define "producer". The court held that the royaly owner was not liable. *State of Oklahoma* v *State of Texas* 266 U.S. 298, 300, 45 S. Ct. 101, 69 L. Ed. 296, 297." (Emphasis supplied)

As was noted in *Burbank, supra*, prior to 1933, Texas law provided a tax on all who engaged in producing crude oil and did not define "producer". Prior to 1933, Texas law provided that a tax shall be paid by:

> "each person owning, controlling, managing, operating or leasing in this state any oil well, or any person who produces in any other manner any oil by taking it from the earth in this state . . ."

The United States Supreme Court, in *State of Oklahoma* v *State of Texas, supra*, interpretating pre-1933 Texas law, held that the royalty owner was not liable for the tax. Subsequently, the Texas oil production tax and gas production taxes were amended to specifically provide that "the tax shall be borne ratably by all interested parties, including royal interests."

Appellants further contend that the phrase "engaged in the business" has specific meaning in oil and gas law. Courts of other states have interpreted severance tax statutes containing that phrase and have attached significance to that phrase as related to royalty owner. In *Burbank, supra*, the Court dealt with a Kentucky statute which originally provided that "every person, firm, corporation and association *engaged in the business* of producing oil in this state,

by taking same from the earth, shall, in lieu of all other taxes on the wells producing said oil imposed by law, annually pay a tax for the right or privilege of engaging in such business." Subsequent amendments to that statute deleted the phrase "engaged in the business". Nevertheless, the Court held that "we think that the first act labeled the 'producer' and later enactments did not change the label". The Court went on to interpret the statute as if the phrase "engaged in the business" remained in the statute. The Court held that the original Act, as amended, could not be construed as placing any part of the tax in question on one who is simply a royalty owner. The Court stated as follows:

> "There may be, as suggested in briefs, cases where the situation may arise, or has arisen, where the lessor may have more than a mere royalty interest where some are co-workers or have operating interests, and other instances pointed out which would make him liable, but as suggested, the present case is exceptional, in that 'it appears that the lessee acts as producer, and purchaser as well as transporter of the oil, and pays to the royalty owner the net proceeds of his 1/8th of oil after deducting the production tax'. We may say that we are now dealing only with the case at hand, and if we should be called upon to determine the question in a case where the *facts* are such as to constitute joint venture or fix joint liabilities, we shall be guided by the *facts* and the law." (Emphasis supplied)

In other words, the determination of whether a particular royalty owner is "engaged in the business" is a *factual* determination. In the instant case, there can be no question but that Judge Forster determined that all Appellant royalty owners were "engaged in the business" without any factual background whatsoever.

In 1948, one year after the *Burbank* decision, the Kentucky statute was amended. The Act, in its present form,

provides that the tax "shall be imposed ratably upon all persons owning any interest in such oil". Therefore, Kentucky is now among those states who specifically provide that the royalty owner is to share in the severance tax.

Two cases interpreting two different statutes in the State of Montana provide additional evidence of the importance of the phrase "engaged in the business". In *Norum v. Ohio Oil Company*, 272 P. 534 (1928) the Court dealt with a license tax on persons "engaged in or carrying on the business of producing" petroleum in the State of Montana. The Court found that such language rendered the license tax an occupational tax and specifically found that a royalty owner is not "engaged in the business."

In *Byrne* v *Fulton Oil Company*, 278 P. 514 (1929) the Court dealt with a Montana tax on net proceeds of mines and mining interests. That Act specifically provided that the operator and the royalty owner were jointly liable for the tax. The operator was authorized to recover or withhold the amount of such tax from any proceeds payable to such royalty owner. The Court found this tax to be in lieu of, or a substitute for, ad valorem taxation on the value of the mines or mining interests. The Court upheld the imposition of this tax on the royalty owner. The Court reaffirmed its position in *Norum* relative to the license tax, distinguishing it from the net proceeds tax:

> "The lower court in this case found that the 2% oil producers' license tax provided for under Section 2397 and Section 2398, et seq., Revised Codes of 1921, as amended by Chapter 67 of the Laws of 1923, may not be withheld by the operator. With this we agree. The royalty owner is not subject to this tax. *Norum* v *Ohio Oil Company*, 83 Mont. 353, 272 P. 534"

The *Norum* and *Byrne* decisions were rendered within a period of one year by the Supreme Court of the State of Montana. The Court in those decisions held that although a royalty owner was not liable for a license tax on producers "engaged in the business", he was liable for a net proceeds tax that the producers were specifically authorized by statute to deduct pro rata from royalty payments. In the Appellants' view, these decisions clearly underscore the importance of the phrase "engaged in the business", and the importance of a specific authorization for the severor to deduct the royalty owner's tax.

Illinois law provides another interesting analysis of the "engaged in the business" phrase. In *Ohio Oil Company* v *Wright*, 53 NE 2nd, 966 (1944), the Court ruled unconstitutional a severance tax which provided for a tax "upon persons engaged in the business of producing oil in this state." The unique aspect of the Illinois statute was the following definition:

> "'Producer' or 'person engaged in the business of producing oil' means any person owning oil or having a royalty interest therein at the time it is taken from the earth or water in this state, whether taken by him or by some other person in his behalf."

The Court ruled that the statute was unconstitutional on uniformity clause grounds. In addition, the Court addressed the "engaged in the business" issue, and found that a royalty owner "does no more than receive the value of the oil as a result of the work of one in fact in the production of it."

The Court went on to state:

> Royalty may be and usually is owned by diverse interests, separate from the person actually engaged in production operations. It may be the owner of the fee invested in an adult, minor, widow, trustee, executor or other person. It may also be owned by one who has purchased a mineral interest from the original land

owner, or even subdivided into many shares. Such royalty owner may not drill for nor take oil from the leased premises without the consent of the lessee, has no control over such operations, and cannot prevent the lessee from entering upon the surface of the premises to produce oil. (citation omitted) It manifestly is not a fact that such royalty owners are in the business of producing oil any more than a stockholder by accepting the dividends from a corporation is in the corporate business, whether the dividends be in cash or property in kind. The legislature does not have the power by legislation to declare that not to be a fact which everyone knows is a fact (citation omitted) and, by the same reasoning, cannot legislate that to be a fact which everyone knows is not a fact. To make the fact of ownership of oil, alone, the criterion of engaging in business of producing oil so obviously includes persons who may not and cannot be in such business as to render it obnoxious to the Constitution." *Ohio Oil, supra*, at 971

The Supreme Court of Appeals of West Virginia's interpretation of their severance tax statute provides an additional means of analyzing the instant case. Under West Virginia law, the operator of a gas well paid a tax levied against persons "engaged in the business of producing gas for sale". The issue of a royalty owner's obligation under that statute was analyzed in *Kanawha Valley Bank* v *United Fuel Gas Company*, 1 SE 2nd, 875 (1939). That case was cited in *Burbank, supra*, as holding that the statute "placed an occupation tax on all persons 'engaged in the business of producing (oil or) gas'. The question here presented was raised there, and the Court held that the *lessee* was the producer." (Emphasis supplied)

The Court in *Kanawha* also addressed the absence of language in the lease, authorizing the deduction of a portion of severance taxes. The Court stated that:

When the parties themselves, dealing at arms length, have carefully, intelligently and in good faith defined their relationship, as in this contract, courts ordinarily do not change that label. Whatever the relationship here, the rights and liabilities of the parties are fixed by the contract. It was first executed in 1932. The production tax has been imposed annually since 1921. The lessee, as a producer of gas prior to 1932, necessarily knew of the tax. Nevertheless, the lessee bound itself to pay the lessor a full 1/8th of the market price of gas at the well — not such price less 1/8th of the production tax. The lessee's deduction would be a material, unilateral modification of the contract, a modification which courts cannot sanction."

A similar analysis can be applied in the instant case. Shell Oil Company has not contended that the leases in question are anything other than silent on the issue of the Michigan severance tax. Under the analysis set forth in *Kanawha*, where the severance tax substantially predated the leases, it could be held that without language in the leases authorizing such deductions, Appellee Shell's deduction of a share of severance taxes constitutes a material, unilateral modification of the contract, a modification which the Courts should not sanction. Further, it is a well established doctrine that a lease is construed most strictly against its draftor, in this case, Shell Oil Company.

Subsequent to the *Kanawha* decision, the West Virginia tax was amended. While continuing to levy the tax on those "engaged in the business" it specifically authorized the severor to deduct that proportion of the tax paid which the royalty bears to the entire production. In *Cole* v *Pond Fork Oil and Gas Company*, 35 SE 2nd 25 (1945) the Court struck down the amending provision as unconstitutional relying, in part, upon the *Wright* decision, *supra*, and its language to the effect that "the legislature does not have the power to declare that not to be a fact which everybody knows is a fact".

Petitioner's Brief Filed With The Michigan Court of Appeals

In summary, it is the contention of the Appellants that the construction of the Michigan severance tax statute by the Trial Court and Appellee would render the phrase "engaged in the business" found in that statute meaningless. Such a construction would violate the canon of statutory construction which states that the courts must avoid declaring any portion of the Legislature's language to be mere surplusage.

Case law interpeting oil and gas production taxes supports Appellants' position in several ways. First, a review of the statutes and cases in other states indicates that those states which tax the royalty owner do so specifically! This factor has been judicially noted by Courts holding that statutes not containing such specific provisions (as the Michigan Act does not) do not authorize the taxation of the royalty owner. *Burbank, supra.*

Second, Courts in Kentucky and Montana have interpreted the phrase "engaged in the business" as not including royalty owners. In Illinois, a severance tax was struck down as unconstitutional, partially on the basis that the Legislature had attempted to "declare that not to be a fact which everyone knows is a fact" by defining "producer engaged in the business" to include the royalty owner.

Further, it has been recognized that the absence of provisions in the oil and gas lease authorizing the withholding of severance taxes should be considered in evaluating whether the lessee should be allowed to withhold severance taxes from the lessor's royalty payments.

Applicable law demonstrates that "engaged in the business" is a significant phrase in a severance tax statute. Further, the absence of a specific provision authorizing withholding of the royalty owner's portion of the tax is also significant. It is Appellants' position that this case law demonstrates that Professor Summers was accurate when he

stated that the royalty owner in Michigan should bear no part of the severance tax burden. Appellants would acknowledge that Professor Summers' conclusion is subject to the proviso that a royalty owner *may be* liable for severance tax if he is, in fact "engaged in the business". The determination of whether a particular royalty owner is so engaged is subject to factual determination and cannot be determined as a matter of law.

Finally, in interpreting a tax statute, any ambiguity should be resolved in favor of the taxpayer. As Justice Williams noted in his discussion of rules of tax statute construction found in *Borden Inc.* v *Department of Treasury*, 391 Mich 495, at 514 (1974), whenever a revenue law contains doubtful language, the courts should resolve all doubts in favor of the taxpayer as long as such an interpretation gives reasonable meaning to the Act. Limiting the burden to pay the tax to entities actually in the business would merely impose on such entities a fractional increase in the cost of doing business, a not unreasonable position.

Applying that principal, it is doubtful whether the Treasury could enforce the existing severance tax upon owners of simple royalty interests, and it follows that Shell Oil Company should be in no better position to impose the Tax upon such owners.

RELIEF REQUESTED

The Judgment of the Grand Traverse County Circuit Court dated April 6, 1982 granting Shell Oil Company Partial Summary Judgment should be reversed. The cause should be remanded to the Grand Traverse County Circuit Court with instructions to determine whether the royalty owners in question are "engaged in the business of severing from the soil, oil or gas" and in the event it is determined that they are not so engaged, to find that Shell Oil Company is not authorized by the terms of the statute (MCLA 205.301, MSA 7.351) to deduct a pro-rata share of severance taxes from royalty payments.

Petitioner's Brief Filed With The Michigan Court of Appeals

STATE OF MICHIGAN
IN THE COURT OF APPEALS

ALBERT K. BROWN, CATHERINE D. BROWN, KENT ROSENBERG, ARLENE ROSENBERG, VICTOR SCHULER, ELIZABETH SCHULER, DONALD E. WOOD, ELLEN L. WOOD, EARL HILLIARD, MARGARET HILLIARD, JEROME A. RAY, KAREN M. RAY, KENNETH R. HILLIARD, JO HANNAH A. HILLIARD, DONALD A. LONGFIELD, SYLVIA D. LONGFIELD, ERNEST C. HILLIARD, BETTY L. HILLIARD, CAROLYN M. WEBBER, ELI HILLIARD, MARGARET L. HILLIARD, GEORGE LEWIS, SONJA SUE LEWIS, MATT KOLB, BERTHA T. KOLB, FRANCIS LATUSZEK, MARY J. LATUSZEK, JAMES F. LAWNICHAK, ROBERTA H. LAWNICHAK, CHARLES V. HOUSE and MARYETTA J. HOUSE,

Plaintiffs - Appellants,

v

SHELL OIL COMPANY, a Delaware corporation,

Defendant - Appellee

COURT OF APPEALS NO. 63011-G

GRAND TRAVERSE CIRCUIT COURT NO. 81-8858-CK

PROOF OF SERVICE

STATE OF MICHIGAN)
) ss.
COUNTY OF GRAND TRAVERSE)

Julie DeVine, being first duly sworn, deposes and says that on June 14, 1982, she served a copy of the Brief of Appellants in the above cause on Webb A. Smith, Esq., Foster, Swift, Collins & Coey, P.C., Foster Bldg., 313 S. Washington Square, Lansing, MI 48933 and Terence V. Lynam, Esq., 105 E. Washtenaw St., Lansing, MI 48933 by enclosing same in a sealed envelope, postage paid, directed

to the said above-named individuals by depositing same in the United States mails at Traverse City, Michigan.

/s/ Julie DeVine

Subscribed and sworn to before me this 14th day of July, 1982.

/s/ Debra L. Nedow
Notary Public
Grand Traverse County, MI
My Commission Expires:
May 28, 1984

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Respondent's Brief Filed With The Michigan Court of Appeals

BRIEF OF APPELLEE

STATE OF MICHIGAN
IN THE COURT OF APPEALS

ALBERT K. BROWN, ET AL,
Plaintiffs - Appellants,

v

SHELL OIL COMPANY, a Delaware corporation,
Defendant - Appellee

Court of Appeals
File No. 63011-G

Circuit Court
File No. 81-8858-CK

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BRIEF OF APPELLEE

ORAL ARGUMENT REQUESTED

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C-27

Respondent's Brief Filed With The Michigan Court of Appeals

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Respondent's Brief Filed With The Michigan Court of Appeals

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COUNTERSTATEMENT OF QUESTIONS INVOLVED

1. WHETHER PLAINTIFFS-APPELLANTS ARE ENTITLED TO DELIVERY OF A SHARE IN KIND OR A SHARE OF THE MONETARY PROCEEDS FROM THE SALE OF GAS OR OIL AS OF THE TIME OF ITS PRODUCTION OR SEVERANCE AND ARE THEREFORE SUBJECT TO THE MICHIGAN SEVERANCE TAX ON GAS AND OIL.

   The Trial Court answered "Yes".

   Defendant-Appellee says "Yes".

   Plaintiffs-Appellants say "No".

2. WHETHER DEFENDANT-APPELLEE IS ENTITLED TO PARTIAL SUMMARY JUDGMENT WHEN THE ALLEGATIONS IN PLAINTIFFS-APPELLANTS' COMPLAINT PLACED THEM WITHIN THE SCOPE OF THE MICHIGAN SEVERANCE TAX ON GAS AND OIL AS A MATTER OF LAW.

   The Trial Court answered "Yes".

   Defendant-Appellee says "Yes".

   Plaintiffs-Appellants say "No".

Respondent's Brief Filed With The Michigan Court of Appeals

COUNTERSTATEMENT OF FACTS

Plaintiffs claim to be owners of interests in minerals underlying various premises in several Michigan counties. Plaintiffs also allege that they have leased their mineral interests to Defendant, that producing oil and gas wells are located on their property, and that their leases entitle them to a portion of the proceeds from the sale of hydrocarbons extracted through said wells. Plaintiffs' share of the proceeds from this hydrocarbon production, known as royalties, generally is calculated as one-eighth (1/8) of the proceeds free of production costs.

A two percent (2%) tax, known as the "severance tax", MSA §7.351, *et seq*, is imposed on the gross market value of all extracted oil and gas, exclusive of the production or proceeds attributable to the state or to the federal government. Pursuant to this statute, Defendant withholds a pro rata share of the tax from the proceeds attributable to Plaintiffs and pays the total amount of the severance tax to the state.

Plaintiffs' suit, in part, challenges the right of Defendant to withhold a pro rata share of the severance tax from the proceeds (royalty) paid to them.

On April 6, 1982, Circuit Judge Charles M. Forster entered partial summary judgment against the Plaintiffs on this severance tax issue. The Court ruled that the severance tax was imposed of a share in kind or a share of the monetary proceeds from the sale of gas or oil at the time of its production or severance from the soil. MSA §7.362(2). Since Plaintiffs admitted in their Complaint that they owned or were entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of gas or oil at the time of its production or severance from their premises, the court ruled as a matter of law that Plaintiffs were subject to the tax.

ARGUMENT

I. THE CIRCUIT COURT CORRECTLY RULED THAT THE PLAINTIFFS ARE SUBJECT TO THE MICHIGAN SEVERANCE TAX.

Plaintiffs claim to be owners of interest in hydrocarbons located under various parcels of property which they own in Michigan's northern lower peninsula. They further allege that they have contracted with Defendant, through mineral leases, for the purpose of extracting hydrocarbons from under their property. Upon executing these mineral leases, Plaintiffs allegedly retained "royalty interests" preserving their right "to share in such minerals as are severed, or to the proceeds thereof." Williams & Meyers, *Oil and Gas Law* § 202.3. Where Plaintiffs have leased their land for purposes of hydrocarbon development and wells on their property are productive, the receipt of royalties may generate substantial income for Plaintiffs.

As Judge Forster properly noted, Defendant's Motion for Partial Summary Judgment raised an issue of statutory construction; whether the severance tax is imposed on the royalty proceeds of lessors who leased their land for hydrocarbon development. The relevant statutes, MSA §§ 7.351 and 7.362(2), provide as follows:

> "There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax." MSA § 7.351.
>
> "'Producer' as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance." MSA § 7.362(2).

The trial court correctly concluded that where one contracts to lease his property for hydrocarbon development in

return for a right to share in such minerals as are severed, or to the proceeds thereof, that person is within the above quoted statutory provisions and therefore is subject to the severance tax.

Plaintiffs have attempted to construe the 1965 amendments to the Severance Tax Act as supporting their position. Under Plaintiffs' construction, only oil companies would be subject to the tax. Plaintiffs fail to say who would be liable to pay the severance tax on that share of the severed hydrocarbons or proceeds of such hydrocarbons attributable to Plaintiff-Lessor's royalty interests. However, Defendant contends that the amending language was an obvious reaction to a prior advisory opinion of the Attorney General, OAG No. 4160 (June 17, 1963), and is consistent with the trial court's ruling that the royalty interest is subject to the severance tax imposed on that share of production attributable to the royalty interest.

Prior to 1965, the Severance Tax Act contained no definition of "producer". Addressing the deduction of a pro rata share of the severance tax from the State of Michigan-Lessor's royalty interest, the Attorney General opined that the severance tax could not be withheld from proceeds otherwise payable to the state. Significantly, Attorney General opinions are not binding on any state court. *Traverse City School District* v *Attorney General*, 384 Mich 390 (1971); *Arrowhead Development Co.* v *Livingston County Road Commission*, 92 Mich App 31 (1979). Moreover, this particular Attorney General opinion is totally inapplicable to the instant situation because it was drafted in response to a specific inquiry regarding deductions from *state lessors*. Although the opinion contains some analytical dicta, MSA § 7.7 was dispositive of the inquiry. That section's exemption of state property from taxation immunized the state lessor from any state imposed severance taxation.

Shortly after this Attorney General opinion was issued, the legislature amended the Severance Tax Act, imposing the tax against "producers" and defining "producers" as "a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance." MSA § 7.362(2). These amendments obviously were intended to clarify ambiguities that the Attorney General opinion may have raised concerning the applicability of the Act to royalty interests. The inclusion of the term "producer" and the accompanying definition clearly delineates the legislature's intent to impose the severance tax against those entities which are entitled to receive the severed hydrocarbons or the proceeds from the sale of severed hydrocarbons. Plaintiffs' Complaint admits that they are entitled to receive a share of the production or the proceeds of such production. By Plaintiffs' own admission, they are "producers" subject to the severance tax and the trial court's entry of partial summary judgment on that issue was appropriate.

Plaintiffs also argue that they are not subject to the tax because they alleged that they are not engaged in the business of severing oil and gas from the soil, an argument Judge Forster properly rejected. Through tortured logic, Plaintiffs compare their position to that of General Motors' stockholders who are not engaged in the business of automobile production. However, Plaintiffs are not bringing this suit as shareholders of Defendant. Rather, as lessor-royalty interest holders, Plaintiffs are more accurately in the position of lessors of land or equipment in the automobile industry who are paid a portion of the proceeds of the sale of automobiles manufactured with their capital. Plaintiffs have a direct involvement in the business of severing hydrocarbons from the soil through their ownership of the mineral interests and their ownership and leasing of their property. Moreover, to argue that Plaintiffs are not in the hydrocarbon

business despite the substantial income which they realize from placing their property into production is ludicrous.

A pro rata split of the severance tax burden is not supported solely by the Michigan Severance Tax Act. Even without the unambiguous language of the Act, the severance tax would be shared by the lessor and lessee as post-production costs. As a general rule, the royalty interest in production is subject to a proportionate share of the costs incurred subsequent to production. Among those post-production expenses is the severance tax. Thus, the royalty interest is subject to a proportionate share of the severance tax. See *Holbein* v *Austral Oil Co*, 609 F2d 206 (5th Cir, 1980); Williams & Meyers, *Oil and Gas Law* § 645.2.

Plaintiffs misplace their reliance on alleged authority contrary to Judge Forster's ruling. The article by Professor Summers cited in Plaintiffs' Brief was prepared prior to the 1965 amendments to the Michigan Severance Tax Act. At the time it was written, Professor Summers was arguably consistent with the prior statutory language and the Attorney General opinion. The 1965 amendments, however, rendered Professor Summers' analysis obsolete.

Similarly, the antiquated extrajurisdictional case law cited by Plaintiffs is inapplicable to the clear language of the Michigan Severance Tax Act. In fact, Plaintiffs' Texas case law presents a situation similar to the Michigan law prior to the 1965 amendments. At the time Plaintiffs' Texas case was decided, the Texas Severance Tax Act was unclear as to who was subject to the tax. After judicial construction of the Act excluded royalty interests from the tax, the Texas legislature amended the Act to include such interests. As in Michigan, the legislature clarified its intent to impose the tax on those entities who actually possess the rights to severed hydrocarbons or the proceeds of the sale of such hydrocarbons upon severance from the soil. By Plaintiffs' admission in their Complaint, they are within this class of entities and are therefore subject to the tax.

Respondent's Brief Filed With The Michigan Court of Appeals

II. THE TRIAL COURT PROPERLY GRANTED PARTIAL SUMMARY JUDGMENT PURSUANT TO GCR 117.2(1).

Plaintiffs apparently argue that Michigan's liberal rules regarding finding questions of fact to exist warrants a reversal of the trial court's order of partial summary judgment. However, Defendant's Motion for Partial Summary Judgment contended that Plaintiffs had failed to state a claim upon which relief can be granted. GCR 117.2(1). Defendant's motion tested only the legal, not factual, sufficiency of Plaintiffs' pleadings. *McCallister* v *Sun Valley Pools, Inc*, 100 Mich App 131 (1980); *Hoag* v *Paul C. Chapman & Sons*, 62 Mich App 290 (1975). Such a motion is granted upon the showing that Plaintiffs' claim must fail because of a fatal legal deficiency. *Saveski* v *California Federal Savings & Loan Assoc*, 63 Mich App 747 (1975).

Ruling on such a motion, Judge Forster properly considered whether Plaintiffs' Complaint stated a claim upon which relief could be granted. As to the severance tax issue, the court concluded that Plaintiffs had no cause of action. Plaintiffs claim to be lessors of property for hydrocarbon development and claim to possess the right to receive a portion of the production, or proceeds from the sale of such production. The allegations of Plaintiffs' Complaint brought them within the scope of the Michigan Severance Tax Act as a matter of law, and the trial court was correct in its entry of partial summary judgment.

RELIEF REQUESTED

WHEREFORE, Defendant Shell Oil Company respectfully requests this court to affirm the entry of partial summary judgment by Circuit Judge Charles M. Forster.

Dated: 8-23-82

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Respondent's Brief Filed With The Michigan Court of Appeals

STATE OF MICHIGAN
IN THE COURT OF APPEALS

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware corporation,
Defendant-Appellee,

File No.: 63011-G
Circuit Court
File No. 81-8858-CK

PROOF OF SERVICE

STATE OF MICHIGAN)
COUNTY OF INGHAM) SS

Candace Mifflin, being duly sworn, deposes and says that on August 23, 1982, she served a copy of the Brief of Appellee filed in the above cause on Philip R. Rosi, P.O. Box 1067, Traverse City, Michigan 49684 by enclosing the same in sealed envelopes, postage paid, directed to the said above-named individual and depositing the same in the United States Mails at Lansing, Michigan.

/s/ Candace Mifflin

Subscribed and sworn to before me this 23rd day of August, 1982.

/s/ Kathleen Zmitko
Notary Public, Shiawassee County, MI
(Acting in Ingham)
My Commission Expires: 2-20-84

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Application to Michigan Supreme Court for Leave to Appeal, Together with Brief and First Supplement to Brief

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware corporation,
Defendant-Appellee.

Supreme Court No.
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

APPLICATION FOR LEAVE TO APPEAL

Albert K. Brown, et al, Plaintiffs-Appellants, hereby apply to this Honorable Court for leave to appeal from the decision of the Court of Appeals affirming the Order for Partial Summary Judgement entered by the Grand Traverse County Circuit Court, rendered by the Court of Apeals on August 16, 1983, and the decision by the Court of Appeals denying an Application for Rehearing which decision was rendered the 8th day of November, 1983, for the following reasons:

GROUNDS FOR APPEAL

I. The subject matter of the appeal involves legal principles of major significance to the jurisprudence of this state:

A. At issue is the interpretation of both the nature and application of the oil and gas Severance Tax, MSA 7.5301 et seq, MCLA 205.301. Although enacted in 1929, the tax has never been judicially construed. Appellants, lessors under oil and gas leases entitled to receive royalties from oil and gas produced on properties leased, urge that the tax is a "Specific tax", a "privilege tax," imposed upon a limited class of persons defined in the act as "producers" and further limited within the act to such producers as are "engaged in the business of sever-

ing from the soil, oil and gas." Appellee has successfully urged before both the Circuit Court of Grand Traverse County and the Court of Appeals that the term "producer" in the Act is broad enough, by definition, to include royalty owners, even though not named in the Act, and that the words "engaged in the business" should not be read restrictively but rather essentially ignored.

Companies, including Appellee Shell Oil Co., have successfully challenged the Constitutionality of oil and gas severance tax laws in other jurisdictions which specifically indentified royalty owners as "producers engaged in the business". The Court of Appeals interpretation of the Michigan Severance Tax extending the scope to royalty owners subjects the entire tax to similar constitutional challenge.

B. A litigant before the courts of this state has the right to expect that a Judge hearing this case, and particularly a Judge of the Court of Appeals sitting as a member of an appeals panel, would disqualify himself from participating in a decision regarding a matter of particular interest to the business of a close member of his family, or at least would advise the litigants of the circumstances. It is essential to the proper administration of justice that all litigants believe that they and their concerns have been dealt with fairly after full, deliberate consideration. To that end, it is necessary that the decision maker avoid not only any actual conflict of interest but also that he avoid any appearance of prejudice.

In this case, Appellants raised the concern that the father of one of the three judges sitting on the panel of the Court of Appeals was possibly intimately involved in an oil and gas company operating in Michigan. Appellee confirmed this suspicion. The Court of Appeals,

however, dismissed this concern without explanation. Courts give written decisions to explain and legitimize their rulings. Without any guidance from the Court regarding this issue Appellants are left completely in the dark as to the reasons for the Court's summary dismissal of their request for rehearing.

II. The decision of the Court of Appeals is clearly erroneous and will cause material injustice.

A. Basic rules of statutory construction were violated:

1. In interpreting statutes, every word should be given meaning and no word should be treated as surplusage.

2. Words must be interpreted according to their ordinary usage.

3. Dubious language in tax laws is to be resolved in favor of taxpayers.

The Severance Tax adopted in 1929 was a "specific tax" imposed upon "each corporation, association or person *engaged in the business of severing from the soil, oil and gas*" (emphasis added). Amended in 1965 as a "specific tax" imposed upon "each producer *engaged in the business of severing from the soil, oil and gas*" (emphasis added), the Court of Appeals, now extends the tax by judicial construction to apply to persons not identified in the Statute and whose only contact with the "business" is that they are entitled to receive royalty income, in the nature of rents for the oil and gas produced from the land. Although the Court of Appeals recognized that the words "engaged in the business" appearing in the title and the body of the Act, both before and after the Amendment, was a "qualifying phrase," the Court imparted no meaning to those words. The Court

concluded that, although before 1965 the tax may have been a privilege tax, the 1965 amendment which primarily substituted the word "producer" for the words "corporation, associations or person" had the effect of changing the tax to one "not in the nature of a business, licensing, privilege or occupational tax".

B. The decision is based on an incorrect premise:

> "In this appeal, Plaintiffs concede that they are producers as defined by the statute."

On the contrary, plaintiffs made no such concession. Plaintiffs did assume, for the sake of argument at one point in their brief, that they were arguably "producers". However, a substantial portion of Plaintiffs' brief specifically relies on the rationale found in a decision of the Supreme Court of Illinois, quoted in the brief, that a royalty owner is not a "producer engaged in the business" and should the legislature seek to extend a privilege tax properly imposed on producers engaged in the business to royalty owners, that extension would render the taxing statute unconstitutional.

C. Without any foundation, the Court concluded that the Legislature intended to change the basic nature of the Severance Tax because of an Attorney General Opinion which noted, among other things, that the use of the words in the severance tax limiting its application to those "engaged in the business" made the tax inapplicable to Royalty Owners. It made that conclusion despite the legislature's retaining those same words in the amended version.

D. The Court equated the Michigan Severance Tax to property taxes of other jurisdictions, Wyoming and Montana, when no parallel was justified.

III. The decision of the Court of Appeals is in conflict with the Court of Appeals decision in *Mobil Oil Corporation*

vs. State of Michigan Dept. of Treasury 121 Mich App 293 (1982).

The Court of Appeals affirmation of the Circuit Court's decision is bootstrapped upon a determination that a royalty owner is a "producer" which is under the Act, "a person who owns, or is entitled to delivery of a share in kind or a share of the monetary *proceeds from the sale of gas or oil* (emphasis added) as of the time of its production or severance." In *Mobil Oil* the Court said "Royalty payments under an oil and gas lease are *not* payments for the purchase of oil produced. Rather, they *are payments for the privilege* of exploiting the land which is the subject of the lease." (emphasis added).

Attached hereto is a copy of documents from the above entitled case including the decision of the Court of Appeals, dated August 11, 1983, a copy of the Order of the Circuit Court of Grand Traverse County, Michigan, entered on April 6, 1982, a copy of plaintiffs- appellants' applications for rehearing with defendant-appellee's Responses, and the Court of Appeals Order denying the Applications. Following is a concise statement of facts and proceedings so far as they are material accompanied by a Brief in support of this application.

Application to Michigan Supreme Court for Leave to Appeal, Together with Brief and First Supplement to Brief

CONCISE STATEMENT OF PROCEEDINGS AND FACTS

1. On April 18, 1929 Michigan adopted an oil and gas severance tax as Public Act No. 48 bearing the title:

> An Act levying a specific tax to be known as the Severance Tax upon all corporations, associations or persons engaged in the business of severing oil and gas from the soil; and prescribing the method of collecting the license; requiring those engaged in the severance of such products to make reports of their business; to provide penalties and to prescribe for the disposition of the funds so collected; and to exempt those paying such specific tax from certain other taxes.

2. In 1965 the Michigan Severance Tax was amended, so far as here applicable, by Public Act 299 substituting the word "producer" for "corporation, association or person" and in the body of the Act adding a definition of "producer" as follows:

> "Producer" as used in this Act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil, as of the time of its production or severance.

3. After the 1965 amendment defendant-appellee, Shell Oil Company, acquired oil and gas leases on plaintiffs' lands which leases contained no provision whatsoever regarding privilege or severance taxes. Shell successfully drilled oil and/or gas wells upon the premises covered by the leases and in the computation of royalties due plaintiffs deducted a portion of the Severance Tax.

4. By action initiated in the Grand Traverse County Circuit Court on February 6, 1981 and amended on November 17, 1981 plaintiffs assert that Shell wrongfully reduced royal-

ties due them by charging them a pro-rata share of the Severance Tax. Plaintiffs alleged that because they were not engaged in the business of severing from the soil oil and gas, Shell improperly deducted a portion of the Severance Tax from the royalties.

5. There have been no prior Court decisions interpreting the Severance Tax statute. However the Michigan Attorney General, prior to the 1965 Amendment, issued two opinions regarding the Act:

(a) Opinion Attorney General 1961-62, #4010 concluded:

"The Michigan severance tax is imposed upon producers and extractors of oil and gas. It is a specific privilege tax as distinguished from a property tax. Its incidence is upon the act of severance."

(b) Opinion Attorney General 1963-64, #4160 noted in part after examining an oil and gas lease with the State which contained no reference to privilege or severance taxes:

". . . The producers or the party engaged in withdrawing the oil and separating it from the ground is the party upon whom the severance tax is levied. In other words, this is a specific tax." . . . . . "Under the Michigan Acts the privilege tax is imposed upon the severor or producer. There is authority to the effect that by statute or by agreement the shifting of this tax can be made to the Lessor. However, that is not the situation here."

6. On March 3, 1982 after hearing oral arguments, Judge Charles M. Forster of the Grand Traverse County Circuit Court granted Shell's Motion for Partial Summary Judgment on the issue of the application of the Severance Tax to the plaintiffs, the Court noting that the question was one of first

impression. Judge Forster ruled that as a matter of law one who falls within the definition of "producer" is engaged in the business of severing from the soil, oil and gas. He further ruled that plaintiffs-appellants, as Lessors under the oil and gas leases, fell within the definition of "producer" and as such were obligated to bear a portion of the tax, issuing an Order dated April 6, 1982.

7. Plaintiffs-Appellants appealed the decision to the Court of Appeals, which by Order dated August 16, 1983, Judge D.E. Holbrook, Jr. presiding, affirmed the Circuit Court's decision. The Court concluded that the 1965 Amendment of the tax law placed the Act in the posture of one "not in the nature of a business, licensing, privilege or occupational tax" imposing the tax not only upon all producers but also upon owners of royalty interests.

8. On September 1, 1983 Plaintiffs-Appellants filed with the Court of Appeals an Application for Rehearing which Application was supplemented by an Application dated September 9, 1983. The Initial Application for Rehearing addressed the merits of the Court's decision. The Supplemental Application, based on knowledge acquired subsequent to the initial application for rehearing, noted a possible familial relationship between Judge D.E. Holbrook, Jr., who sat on the panel hearing the appeal and Donald E. Holbrook, Secretary of Grant Oil Company. In response to the Supplemental Application, defendant-appellee noted that Judge Holbrook is the son of Donald E. Holbrook, secretary of Grant Oil Company, stating without corroboration, that Grant Oil Company had been involved in some unsuccessful drilling activity, but that the company "has not been active since 1981". The Court of Appeals denied the Application for Rehearing without comment concerning the familial relationship or the accuracy of defendant-appellee's representations.

PRAYER FOR RELIEF

Wherefore, Albert K. Brown, et al., Plaintiffs, hereby pray that this Honorable Court grant them leave to appeal from the decision of the Court of Appeals affirming the Circuit Court's order granting partial summary judgment and from the Order of the Court of Appeals denying Plaintiffs-Appellants' Application for Rehearing.

Respectfully submitted,

THOMPSON, ZIRNHELT, BOWRON, SENGER & ROSI, P.C.

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Dated: November 23, 1983

C-48

Application to Michigan Supreme Court for Leave to Appeal, together with Brief and First Supplement to Brief

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

Supreme Court No.
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

BRIEF IN SUPPORT OF PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

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BRIEF IN SUPPORT OF APPLICATION FOR LEAVE TO APPEAL
ISSUES PRESENTED:

1. Are legal principles of major significance to the jurisprudence of the state at issue when judicial construction of a tax law, not previously judicially construed invites a constitutional attack which has been successful in other states?

2. Does the imposition of tax obligations under the oil and gas Severance Tax statute upon persons not specified in the statute involve legal principles of major significance to the Jurisprudence of the state?

3. Was the decision of the Court of Appeals clearly erroneous, causing material injustice, when it interpreted the scope of the Severance Tax on "producers engaged in the business severing oil and gas from the soil" to include within that class of taxpayers *royalty owners*, a class of persons that courts of other states have uniformly ruled are not "engaged in the business" of severing oil and gas from the soil?

4. Was the decision of the Court of Appeals clearly erroneous causing material injustice when it was predicated

on a "concession" of a legal issue attributed to plaintiffs, which concession plaintiffs never made?

5. Was the decision of the Court of Appeals clearly erroneous causing material injustice when it mistakingly considered crucial language of the act as having been new language added at the time of the 1965 amendment, when the language had actually been present in the Act since its initial adoption in 1929.

6. Is the decision of the Court of Appeals concluding that royalty owners fall within the definition of "producers"

> ". . . a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of gas or oil as of the time of its production or severance . . ."

in conflict with a prior Court of Appeals decision stating that oil and gas royalties are "payments for the privilege of exploiting the land which is the subject of the lease" and are akin to "rental payments?"

7. Did the failure of the Court of Appeals to grant a rehearing after disclosure of the business interests of the father of Judge D.E. Holbrook, Jr. involve legal principles of major significance to the Jurisprudence of the state?

QUESTION PRESENTED TO THE COURT OF APPEALS:

1. Does the Michigan Severance Tax Statute (MCLA 205.301 et seq., MSA 2.351 et seq.) obligate a person whose sole interest in an oil and gas well is a royalty interest, to bear a portion of the severance tax?

The Circuit Court answered ..... Yes.

Appellants answered ..... No.

The Court of Appeals answered ..... Yes.

2. Does the allegation in Plaintiffs' Amended Complaint that Plaintiffs are not engaged in the business of severing from the soil, oil and gas, raise a factual issue sufficient to bar a Motion for Summary Judgment?

The Circuit Court answered ..... No.

The appellant answered ..... Yes.

The Court of Appeals answered without discussion ..... No.

ARGUMENT

I — THE COURT OF APPEALS DECISION WILL MAKE THE TAX ACT CONSTITUTIONALLY INFIRM

The Michigan Severance Tax has not previously been judicially construed. By concluding that Royalty Owners are subject to a tax on "Producers engaged in the business of severing oil and gas from the soil," the Court of Appeals has invited constitutional attack of the Statute placing in jeopardy a substantial source of State Tax revenue, $82.7 Million in Fiscal Year 1980-81. Oil Companies including Shell Oil Company have successfully challenged the constitutionality of a Severance Tax statute imposed upon Royalty Owners. *Ohio Oil Co. v Wright* (1944) 386 Ill. 206 53 N E 2d 966. In *Ohio Oil Co. v Wright* (supra) the Illinois Supreme Court decided three companion cases brought by Ohio Oil Co., Superior Oil Co., and Shell Oil Company, Appellee in these proceedings. At issue was the constitutionality of the Illinois Severance Tax, a tax "upon persons engaged in the business of producing oil" in Illinois. The Court concluded that because the tax included within the definition of "producer" a "royalty owner at the time the oil is taken from the land", the tax was invalid, not only because it violated the Uniformity Clause of the Illinois Constitution, but also because although the title of the Act purported to place a tax upon those engaged in the business, and was thus an occupation tax, the body of the Act placed the tax upon persons not in the occupation. The precise result of the Michigan Court of Appeals decision is to create in the Michigan tax the deficiencies fatal to the Illinois tax.

In addition to the Court of Appeals' interpretation of the 1965 amendment to the severance tax act as changing the fundamental nature of the tax renders that amendment subject to constitutional challenge. Article 4, Section 24 of the Constitution of 1963 requires:

> "No law shall embrace more than one object, which shall be expressed in its title. . ."

That identical language appearing in Article 5, Section 21 of the 1908 Constitution was analyzed by this court in *Continental Motors vs. Muskegon Township* 376 Mich. 170 (1965). In the present case the Court of Appeals viewed the 1965 Amendment as changing the fundamental character of the tax from a privilege tax to "one not in the nature of. . . . a privilege tax . . . . ." Under the holding of *Continental Motors*, a case involving a successful attack on the Constitutionality of an amendment to a portion of the general property tax law, such an Amendment would have been unconstitutional unless "the title is also amended to indicate that a fundamentally different type of tax is being imposed. . ." *Continental Motors* 376 Mich. at 181.

II — THE COURT OF APPEALS IGNORED ELEMENTARY PRINCIPLES OF STATUTORY CONSTRUCTION, BASIC TO THE JURISPRUDENCE OF THE STATE

Of paramount importance to the jurisprudence of the State is the judicial interpretation of the legislative intent of tax laws. In the balancing of interest between the State as the taxing entity and individuals as taxpayers, the judiciary has historically followed the rule that any ambiguity in a tax law is to be resolved in favor of the taxpayer. "The scope of tax laws cannot be extended by implication or forced construction, and language, if dubious, is not resolved against the taxpayer, *Waterways Navigation Co. v Corporation and Securities Comm.*, 323 Mich 153 (1948); *Metzen v Department of Revenue* 310 Mich 622, 627, *Standard Oil Co. v Michigan* 283 Mich 85 (1937), *Iron St. Corp. v Unemployment Comm* 305 Mich 643 (1943).

The only ambiguity, if one exists, is in the definition of the words: "Producers engaged in the business." The title of the Statute does not appear ambiguous:

> "AN ACT levying a specific tax to be known as the severance tax upon all producers engaged in the business of severing oil and gas from the soil;. . . . . ." MCLA 205.301 et seq.

The definition of Producer within the body of the act is not so clear:

> "Producer" as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance. MCLA 205.312(2).

The definition does not expressly identify royalty owners, and the definition of royalty by the Court of Appeals in *Mobil Oil v State of Michigan Department of Treasury* 121 Mich App. 293 (1982) would indicate that royalty owners are not within the definition of "producer":

> "Royalty payments under oil and gas lease are not payments for the purchase of the oil and gas produced. Rather, they are payments for the privilege of exploiting the land which is the subject of the lease."

Further, if the rule of *Waterways* is applied and the interpretation is in favor of the citizen taxpayer, there can be no question but that the royalty owner would not be subject to the tax. Equally, if the *Waterways* rule is applied to interpreting "producers engaged in the business", royalty owners also would not be subject to the tax, contrary to what the Court of Appeals has ruled.

"Engaged in the business" are words denoting a tax upon an occupation. *Bailey v Muskegon County Board of*

Commissioners, 122 Mich App. 808 (1983), *Ohio Oil Co. v Wright*, 386 Ill. 206 53 NE 2d 966 (1944) The Illinois Supreme Court addressed the specific question: "Is a royalty owner in an occupation or is he in receipt of income. If in the first classification the royalty owner may be subject to an excise tax — the severance tax. If in the second classification, the royalty owner can only be taxed as an owner of property." 53 NE 2d at 969.

The rule of *Waterways* aside, to include royalty owners within the class of "producers engaged in the business" violates other basic rules of interpretation.

> "In exercising the judicial function of determining legislative intent, courts must interpret words according to their ordinary usage and in the sense in which they are understood and employed in common language, and when the legislature uses a certain phrase or word in a statute, the court must presume it was used in its normally accepted meaning." *Chrysler Corp.* v *Washington*, 52 Mich App 229, 234 (1974).

"It manifestly is not a fact that such royalty owners are in the business of producing oil any more than a stockholder by accepting dividends from a corporation is in the corporate business, whether dividends be cash or property in kind. The legislature does not have the power by legislation to declare that not to be a fact which everyone knows is a fact . . . . . and by the same reasoning, cannot legislate that to be a fact which everyone knows is not a fact. *Ohio Oil Co.* v. *Wright*, supra at 53 N.E. 2d 971-972.

Beyond the ordinary usage rule, "In arriving at the legislative intent in using certain words, it is helpful to refer to other . . . . . statutes (on the same subject) where the same words are used . . . . . it (being) fair to assume they were intended to have the same meaning in this statute." *Szytelko*

v *Estate of Smith* 259 Mich 519 (1932), and in order to ascertain the real intent it is often necessary to consider the provisions in question in connection with other statutes. *Whipple* v *Saginaw Circuit Judge* 26 Mich 342 (1873).

Using such principles, *Public Act No. 61 of 1939*, the *Declaration of State Policy as to Conservation of Oil or Gas*, (MCLA 319.1) et seq must be examined. It specifically identifies *Producers* as the operators of a well, whether or not owners, a classification distinct from a royalty owner.

The decision of the Court of Appeals justifying Shell Oil Company's action in unilaterally imposing a share of the tax upon royalty owners conflicts with established rules of construction and the correctness of such a decision must be carefully scrutinized. Courts are not at liberty, in order to effectuate what they suppose to have been the intention of the legislature, to put upon a statute a construction not supported by the words. *Leoni Township* v. *Taylor* 20 Mich 148 (1870).

As was argued above, the Court of Appeals construction of the 1965 Amendment renders that amendment constitutionally unsound. It is fundamental to assume that the legislature's intent was to amend the statute in a constitutional manner. It is unreasonable to assume that the legislature's intent was otherwise. *Pigorsh v Fahner*, 386 Mich 508,514 (1972). Since the title to the Act was not amended to indicate that a fundamentally different type of tax was being imposed as a result of the amendment, the amendment should not be construed as having resulted in such a fundamental change.

III — THE COURT OF APPEALS COMMITTED CLEAR ERROR

The Court of Appeals erred at least 6 times in reaching its conclusion.

A. First, with no evidence in support, it concluded that the 1965 Amendment to the statute must have not only been in response to an Attorney General's Opinion concerning the statute but suggested it was done to correct a supposed defect in the predecessor statute. No mention is made of what defect was contained in the predecessor statute and examination of the Attorney General's opinion does not disclose any discussion of a defect. Further, the Court of Appeals found that the Amendment was in response to the Attorney General's opinion with no evidence to support that conclusion.

B. The tax is imposed upon "producers engaged in the business . . ." and the circuit court concluded that royalty owners are "producers" as defined by the statute. The Court of Appeals prefaced their opinion by saying that Plaintiffs conceded they are "producers" as defined by the statute. Plaintiffs have never conceded this fact and have indeed consistently contended that they are not taxpayers defined by the statute. The most Plaintiffs did was to assume at one point in their Brief, solely for the sake of argument that they were producers. Such did not constitute a concession and should not have been so considered.

C. In addressing the issue of the statutory language "engaged in the business" the Court of Appeals citing *Melia* v *Employment Security Commission* 346 Mich 544 (1956) stated at page 3 of its opinion "While every word or phrase of a statute is to be given effect an amendment is generally construed as changing the meaning of a statute." Then ignoring the further mandate of *Melia* that "no portion

of the statute should be rendered nugatory." *Melia, supra* at 562, the Court did just that! It jumped to the conclusion that the intent of the legislature was to alter the basic nature of the tax from a privilege tax to a property tax, rendering meaningless the words "Specific Tax" found in the title and body of the Act. Specific taxes are generally of the nature of license taxes, business or occupation taxes and requiring no assessment beyond a mathematical computation. *Pingree* v. *Auditor General* 120 Mich 95, 101 (1899). It also rendered meaningless the words "engaged in the business" after previously identifying those words as a "qualifying phrase." [Opinion page 4] There is nothing to support the Court's conclusion; indeed, the specific language preserved in the statute at the time of the 1965 amendment, both in the title and body of the act refers to the tax as being a "specific tax" imposed on those "*engaged in the business of severing oil and gas from the soil.*" (Emphasis added). The Court of Appeals attempted to buttress its conclusion by noting that Section 15 of the Act provides that the severance tax is "in lieu of other taxes" upon the oil and gas. In doing so, the Court ignored the fact that the quoted section was a part of the statute prior to the 1965 amendment. Moreover the use of the words "in lieu of other taxes", in any case, does not establish that the tax in question is a property tax. *Eastern Gulf Oil Co.* v *Kentucky State Tax Commission* 17 F2d 394 (1926). For example, the *Motor Fuel Tax* (MCLA 207.101 et. seq.) specifically entitled a "privilege tax" is "in lieu of all other taxes upon the sale and use of gasoline" (MCLA 207.113) The Supreme Court, in *Roosevelt Oil Company vs. Secretary of State*, 339 Mich. 679, (1954) noted that the "purpose of the gasoline tax act is to prescribe a *privilege tax* . . . by imposing a *specific tax* upon sale or use of gasoline within the state." (Emphasis added)

D. The Court of Appeals concluded that the basic intent of the severance tax was changed by the 1965 amendment.

There is nothing in the 1965 amendment of the Act, its title, or legislative history which indicates that the basic nature of the tax was to be changed from a privilege tax to a property tax. That conclusion totally ignored the words "specific tax" which by their nature denote something other than a property tax *Pingree* v *Auditor General*, supra.

E. The Court of Appeals recognized that if the tax was a privilege tax applicable to royalty owners it could not withstand Constitutional attack. By finding it to be a property tax, despite the clear language of the act to the contrary, the Court urged that the tax was constitutionally sound, citing the cases of *Bryne* vs. *Fulton Oil Co.* 85 Mont. 329; 278 P514 (1929) and *Miller* vs. *Buck Creek* 38 Wy 505; 269 P43 (1928). Those cases are clearly distinct from this. *Bryne* involved a tax on mining property, such property to be valued by the Montana State Board of Equalization after submission of annual reports of net proceeds of the mines. In *Miller* the tax was again on mines or mining claims and the Wyoming State Board of Equalization was to determine the value of such mines upon annual reports of the gross product submitted by the mine owners. No governmental body has any role to play in the determination of the Michigan Severance Tax, even remotely equivalent to that of the Montana or Wyoming State Board of Equalization. Reliance by the Court on those cases is misplaced. The distinction between an excise tax and a property tax has been drawn by this Court. *Continental Motors v. Muskegon Twp* 376 Mich 170 (1965). To be a property tax, assessors have a role to play. Without assessors, the tax must be an excise tax.

The Court avoided mention of the title of the Act, the essence of which has remained unchanged. The Act imposed a "specific tax" upon those "engaged in the business of severing oil and gas from the soil." The Court did not address the inconsistencies between its conclusion that

the tax was ". . . not in the nature of a business, licensing, privilege or occupational tax" when the title said otherwise.

Although the Court of Appeals construed the intent of the legislature in amending the statute to be a response to the Attorney General's assertion that the tax is not applicable to royalty owners, the Attorney General in his opinion in determining that royalty owners are not subject to the tax specifically relied on the words "engaged in the business". It is logically inconsistent to conclude that the legislature, in response to the Attorney General's opinion, intended to extend the Severance Tax to royalty owners, while at the same time it retained the very language relied upon by the Attorney General when he concluded that the tax was not applicable to Royalty Owners. If the purpose of the 1965 Amendment was to correct an ambiguity and extend the Severance Tax to royalty owners, the legislature would have unambiguously said so. Instead, it retained the qualifying words "engaged in the business" relied upon by the Attorney General in reaching his conclusion.

Until the Court of Appeals decision, neither Appellants, Appellee nor the lower court disputed that the tax was a privilege tax, a tax on those "in the business". Shell urged that royalty owners are "engaged in the business" and the Circuit Court ruled likewise finding that royalty owners of mineral interests are "producers engaged in the business," and therefore subject to the tax. The Court of Appeals determination was clear error: It ignored the plain language of the statute to the contrary and relied upon the language in Section 15 of the Severance Tax Act providing that the severance tax "shall be in lieu of all the taxes, state or local, upon the oil or gas . . . . . ." The language quoted above in Section 15, which was unaffected by the 1965 Amendment, does not support the conclusion of the Court of Appeals.

The Court of Appeal's affirmation of the Circuit Court's conclusion that royalty owners are producers under the statute is unexplained. To be a "producer" a royalty owner must be "entitled to delivery of a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance." The Court did not analyze the extent of the rights of a royalty owner and the record below contained no such analysis. Indeed the Court of Appeals in the case of *Mobil Oil* vs. *State of Michigan Department of Treasury, supra,* recognized "royalty payments under an oil and gas lease are not payments for the purchase of the oil and gas produced. Rather, they are payments for the privilege of exploiting the land which is the subject of the lease." The court cited with approval *Burnett* v *Harmell,* 287 U.S. 103; 77 L. Ed. 199 (1932). That case not only recognized that the lessor retained no title or ownership rights in the oil and gas produced but also held "By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. (287 U.S. at 107). (P)ayments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent." 287 U.S. at 108. Royalty payments are treated wholly as income to the royalty owner Sec. 61(a)(6) of Internal Revenue Code of 1953, as amended, 26 USC 61(a)(6). They are not treated as return of capital or as proceeds from the sale of property. (*Mobile Oil v State of Michigan Dept. of Treasury, supra* and have been consistently held to be rent, or in the nature of rent. *Ohio Oil* v *Wright, supra.*

IV — APPELLANTS SHOULD HAVE BEEN ENTITLED TO REHEARING BECAUSE OF A CONFLICT OF INTEREST OR THE APPEARANCE OF CONFLICT OF INTEREST OF A MEMBER OF THE FAMILY OF AN APPEALS COURT JUDGE.

The right of all litigants to an unbiased judiciary is unquestioned. Basic to the American judicial system is the requirement that proceedings be conducted at all levels in a manner to preclude not only actual bias but the appearance of bias, all for the purpose of insuring that the sanctity of judicial institutions is beyond reproach.

The panel of the Court of Appeals consisted of D.E. Holbrook, Jr. sitting as the principal judge with H. Hood and T.M. Green as supporting judges. Judge Holbrook's father D.E. Holbrook, Sr., is secretary of Grant Oil Company of Clare, Michigan, a company engaged in the exploration for oil. This information was unknown to Appellants prior to the Court of Appeals' decision; although the issue was raised to the Court of Appeals in an application for rehearing, the Court ignored the matter when it denied the application.

Appellants should have been informed of Judge Holbrook's father's involvement in the oil and gas business at the time the panel was chosen and the case assigned. Appellants further urge that, on his own motion, Judge Holbrook should have raised the matter and identified his father's involvement in the oil and gas industry. Cannon 2 of the Code of Judicial Conduct, *Floyd v Miller Lumber Co.*, (1923) 160 Ark. 17, 254 S.W. 450. In *Floyd* a case involving a severance tax applicable to the lumber industry, the decision of the Arkansas Supreme Court noted that one Judge disqualified himself from participating in at least a portion of the case "on account of certain of his relatives being largely

interested in a lumber corporation, engaged in the business of servering timber from the soil for commercial purposes. . . ." Because the circumstances for potential conflict had been ignored by the Court of Appeals and not raised in the first instance by Judge Holbrook, the Appellants have been denied the opportunity to make a record on this issue and may have been denied the right to have an impartial panel hear their appeal.

RELIEF

For the foregoing reasons and because the subject matter of the appeal involves legal principles of major significance to the jurisprudence of the State, Plaintiffs-Appellants respectfully request this Court grant the application for leave to appeal.

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C-67

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FIRST SUPPLEMENT TO BRIEF IN SUPPORT OF PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

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FIRST SUPPLEMENT TO BRIEF IN SUPPORT OF PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

In further support of Section I of the Argument that the Court of Appeals Decision will make the tax act Constitutionally unfirm, attention is directed to the older case of the *Northwestern Manufacturing Company vs. Fitzwilliam H. Chambers, Circuit Judge for Wayne County* 58 Mich. 381 (1885). There this Court analyzed in detail the constitutional restrictions on the authority of the legislature to incorporate within the body of an act matters not included in its title. The Court considered the legal efficacy of a statute purportedly regulating the manufacture and sale of dairy products which law in the body mandated certain dairy products illegal *per se* and also provided for a vehicle for mandatory condemnation of plants, property and equipment. The Court finding the statute unconstitutional as deviating from its title stated:

> "The purpose of the statute so far as it is lawful, must be determined by its title, and it is not competent to use one title and explain in the body of the act that it means something else. The constitutional rule requiring the title to contain the object of the act would be a farce if there were any power in the legislature to give new meanings to language . . ." 58 Mich. at 383-4.

" . . . But, whatever authority the law-making power possesses, the Constitution will not permit Legislature or citizens to be misled by embodying in any statute provisions which are not indicated by its title, to which all have a right to look for guidance in their searches after the law."

The peculiar phraseology of this act would seem to indicate that it was drawn up somewhere else, and it may possibly have been borrowed from some state where there is no requirement that titles shall be veracious indexes to legislation. Our own legislative bodies have not been trained in that way, and such is not our law." 58 Mich. at 385.

Respectfully submitted,

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Dated: November 23, 1983

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PROOF OF SERVICE

The undersigned certifies that copies of First Supplement to Brief in Support of Plaintiffs-Appellants' Application for Leave to Appeal were served upon the Clerk of the Court of Appeals, Ronald L. Dzierbicki, and Attorneys for Defendant, Shell Oil Company, namely Webb A. Smith, Esq., FOSTER, SWIFT, COLLINS & COEY, P.C., 313 S. Washington Square, Lansing, MI 48933 and Terence V. Lynam, Esq., LYNAM & GLYNN, 105 E. Washtenaw Street, Lansing, MI 48933 in the above cause by enclosing same in an envelope bearing return address, addressed to such attorney at their business address as disclosed by the Pleadings of record herein, with postage fully prepaid and by depositing same in the U. S. Post Office mail box in Traverse City, Michigan 49684.

(s) Esther L. Cooper

Subscribed and sworn to before me this 28th day of November, 1983.

(s) Lois Van Valkenburgh, *Notary Public*
Grand Traverse County, Michigan
My Commission Expires: 12/5/83

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DEFENDANT-APPELLEE'S BRIEF IN OPPOSITION TO APPELLANT'S APPLICATION FOR LEAVE TO APPEAL

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COUNTER-STATEMENT OF ISSUES

DOES APPELLANTS' APPEAL INVOLVE LEGAL PRINCIPLES OF MAJOR SIGNIFICANCE TO THE JURISPRUDENCE OF THE STATE.

Appellants say "Yes".

Appellee says "No".

WHETHER THE COURT OF APPEALS' DECISION WAS CLEARLY ERRONEOUS.

Appellants say "Yes".

Appellee says "No".

WHETHER THE COURT OF APPEALS WAS IN CONFLICT OF INTEREST.

Appellants say "Yes".

Appellee says "No".

COUNTER-STATEMENT OF FACTS

Appellants' concise statement of facts is, in many instances, incorrect or misleading. In response, Appellee submits the following:

1. Appellants correctly note that Michigan adopted an oil and gas severance tax in 1929.

2. Appellants correctly note that the severance tax statutes were amended in 1965.

3. Appellants correctly note that Appellee Shell Oil Company and Appellants entered into leases for exploration of hydrocarbons. However, Appellants failed to note that these leases provide for payment of royalty to Appellants calculated as a portion of the severed hydrocarbons in kind or a portion of the net proceeds of the sale of hydrocarbons severed from the soil.

4. Appellants did file an action against Appellee Shell Oil Company. However, the remaining ascertions in paragraph 4 of Appellants' concise statement of facts are without merit in that Shell does not "charge" Appellants a tax, but merely deducts Appellants' share of the tax from royalty payments. The severance tax is "charged" by the State of Michigan.

5. The Michigan Attorney General did, in fact, make administrative rulings concerning the severance tax which are not applicable or binding in this suit.

6. Appellants correctly note that the trial judge ruled that Appellants were entitled to a share of the monetary proceeds from the sale of hydrocarbons and were therefore subject to the severance tax.

7. Appellants correctly note that the Court of Appeals affirmed Judge Forster's ruling. The Court of Appeals ruled

that the owners of royalty interests were "producers" as defined by the severance tax statute.

8. Appellants did apply for rehearing and later supplemented their application for rehearing with a *suggestion* that Judge Holbrook's father *may have been* involved in a business *somehow* related to an industry that *might* have a *curiosity* about the Court's ruling. Appellants made no record to support their application. Had Appellants investigated their assertion, they would have discovered that Judge Holbrook's father, a retired appellate judge himself, had pooled some resources with business acquaintances several years ago, drilled for oil on two occasions in 1981, was unsuccessful in discovering oil, and has not been involved in any aspect of the oil and gas industry since 1981.

ARGUMENT

I. THE LEGAL PRINCIPLES AT ISSUE ARE NOT OF MAJOR SIGNIFICANCE TO THE JURISPRUDENCE OF THE STATE.

Appellee Shell contends that Appellants' argument fails to establish a legal principle of major significance to the jurisprudence of the state as required by GCR 853. This prerequisite to Supreme Court appeal reflects this Court's basic policy that its energies should be devoted to reviewing only important matters. This basic policy can be effectively implemented only through the cautious exercise of this Court's discretion.

Appellants suggest that the Court of Appeals opinion subjects the severance tax to constitutional attack and therefore is of major significance to the jurisprudence of this State. However, there has been no constitutional attack of the Michigan statutes in this case or in other known litigation. Appellants have not questioned the Court of Appeals' recognition that "Plaintiffs did not raise any constitutional challenges in this case." (Court of Appeals slip opinion at page 5). Thus, the purported constitutional issue raised by Appellants is not an issue raised in this case. Moreover, Appellee would not be a proper party to sue over alleged constitutional violations in the severance tax statutes. In this case, Appellants merely challenged Shells' practice of paying that part of the State's severance tax levied on Appellants' royalties with deductions from the royalty payments. The trial court and Court of Appeals properly ruled that royalty interests were subject to the tax imposed by the State and that Shell was acting properly in paying the royalties' share of the tax from the royalty payments. The rulings involve no constitutional analysis and no issues of major significance to the jurisprudence of this State.

II. THE COURT OF APPEAL'S DECISION WAS NOT CLEARLY ERRONEOUS.

Alternatively to their argument that major legal principles are involved, Appellants argue that leave should be granted because the Court of Appeals decision was allegedly clearly erroneous. Appellee contends that the same cautious exercise of discretion should dictate the evaluation of this argument so as not to dissipate the energies of this Court unnecessarily.

Appellee contends that the Court of Appeals decision was *not* clearly erroneous. Rather, the Court employed the correct principles of statutory construction to interpret the appropriate assessment of the severance tax. The Court of Appeals properly noted that the primary, fundamental and cardinal rule of statutory construction is to ascertain and give effect to the intention of the law making body. *Moore* v *Department of Military Affairs*, 398 Mich 324 (1976); *Troy* v *Cleveland Pneumatic Tool Co*, 109 Mich App 361 (1981). All other rules of statutory construction are designed only to assist the Court in determining the true legislative intentions. *VanAntwerp* v *State*, 334 Mich 593 (1952).

In this case, the Court of Appeals correctly looked to the language of the statutes and the legislative history of the severance tax provisions to determine the legislative intent. *Crawford* v *School District No. Six*, 324 Mich 564 (1955); *Wayne County Republican Committee* v *Wayne County Board of Commissioners*, 70 Mich App 620 (1976). Prior to 1965 the severance tax statutes did not define "producer" and the tax was then imposed on "each corporation, association or person engaged in the business of severing from the soil, oil or gas." In a 1963 opinion addressing the deduction of a pro rata share of the severance tax from the State of Michigan lessor's royalty interest, the Michigan Attorney General ruled that MSA §7.7 expemted the state's property

from taxation and immunized the State lessor from any State-imposed servance tax. Although MSA §7.7 was dispositive of the case, the Attorney General's Opinion contained dicta which suggested that royalty interest owners might not be subject to the severance tax.

Shortly after this Attorney General Opinion was issued, the legislature amended the severance tax statutes so as to impose the tax on "producers":

> There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax. MSA §7.351.

These amendments also included for the first time a definition of "producer".

> "Producer" as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance. MSA §7.362(2).

These amendments were obviously intended to clarify ambiguities that the Attorney General's opinion may have raised concerning the applicability of the Act to royalty interests. The inclusion of the term "producer" and the accompanying definition clearly dilineates the legislature's intent to impose the severance tax against those entities which are entitled to receive the severed hydrocarbons or the process of the sale of the sale of those hydrocarbons. Appellants' Complaint admits that they are entitled to receive a share of the production or of the proceeds of such production. Therefore, by Appellants' own admission, they are "producers" subject to the severance tax.

Appellants' excessive reliance on the "engaged in the business" language within the statutes is misplaced, and the

Court of Appeals properly rejected their argument for two reasons. First, the language of the statutes, particularly in light of the 1965 amendments, clearly evidences a legislative intent to impose the severance tax on those entities which receive a share of the proceeds of hydrocarbon production. Appellants would have this Court employ a literal interpretation of a portion of the statute which would lead to a result clearly contrary to the legislative intent. Adopting Appellants' argument would violate this Court's mandate to reject a literal construction contrary to the legislative content. *L.A. Darling Co* v *Water Resources Commission*, 341 Mich 654 (1955); *Bennetts* v *State Employees Retirement Board*, 95 Mich Appeals 616 (1980).

Appellants are also incorrect in their denial that they are, in fact, "engaged in the business." Appellants have a direct involvment in the business of severing hydrocarbons from the soil through the ownership of the mineral interests and the ownership and leasing of their property for purposes of hydrocarbon development. Moreover, to argue that Appellants are not in the hydrocarbon business despite the substantial income which they realize from placing their property into production is ludicrous.

III. THE COURT OF APPEALS WAS NOT IN CONFLICT OF INTEREST.

On rehearing, Appellants suggested that Judge Holbrook should have excused himself for bias because of the entry of Donald E. Holbrook, Sr. as Secretary of Grant Oil Company in the 1982 edition of the Michigan Petroleum Directory. The Court of Appeals did not ignore Plaintiffs' argument, it considered it and rejected it for lack of merit.

Appellants failed to develop any record that Judge Holbrook's father is engaged in any enterprise that would create a conflict with Judge Holbrook's consideration of the issues raised in Appellants' complaint. It was apparent that Appellants raised the argument without any investigation or understanding of the assertions made. After receipt of Appellants' supplement to their application for rehearing, Appellee conducted a brief investigation which disclosed that Judge Holbrook's father, a retired appellate judge himself, had pooled resources with business acquaintances to form the short-lived entity "Grant Oil Company". In its cursary investigation, Appellee learned that this entity operated only briefly, drilled two "dry holes" and has not been active since 1981.

Donald E. Holbrook, Sr.'s position as secretary of a non-operating oil company does not fall within any of the circumstances of GCR 912 that require disqualification of a judge. Moreover, Appellants made no attempt to show actual personal prejudice or bias on the part of Judge Holbrook.

Had Judge Holbrook harbored bias in favor of Appellee because of his father's past business operations or for any other reasons, he would have disqualified himself from this case. However, it is obvious that Judge Holbrook's father was not engaged in any oil related enterprises at the time he participated in this case. In addition, Appellants have not demonstrated that Judge Holbrook's father was ever involved in a business that would conflict with their claims against Shell. Appellants' claims of conflict are thus without merit, and certainly do not warrant appeal to the Supreme Court.

RELIEF REQUESTED

WHEREFORE, Appellee Shell Oil Company respectfully requests this Court to deny Appellants' application for leave to appeal.

Respectfully submitted,

FOSTER, SWIFT, COLLINS & COEY, P.C.
Attorneys for Appellees

By (s) Scott A. Storey (P 30232)
Webb A. Smith (P 20718)

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Dated: 12-20-83

First Supplement to Application for Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

Supreme Court No. 73097

Court of Appeals No. 63011

Lower Court No. 81-8858-CK

SUPPLEMENT TO PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

Albert K. Brown, et al, Plaintiffs-Appellants, as a Supplement to their Application for Leave to Appeal dated November 23, 1983, state as follows:

1. Plaintiffs-Appellants applied to this Court for Leave to Appeal on November 23, 1983. In that Application, one of the grounds for appeal is that the decision by the Court of Appeals in this case conflicts with the decision of that Court in *Mobil Oil Company v Department of Treasury*, now pending before this Court in Docket No. 70388.

2. On June 22, 1984, this Court Ordered that the Application for Leave to Appeal in this case be held in abeyance pending the Court's decision in *Mobil Oil Company v Department of Treasury*, since the decision in that case may be decisive of an issue raised in the present Application for Leave to Appeal.

3. Since the time of Plaintiffs-Appellants' Application to this Court, the Court of Appeals has issued a decision in *The Market Place v. City of Ann Arbor*, 134 Mich. App. 567 (1984), which also conflicts with the Court of Appeal's Decision in this case. Specifically, the Court of Appeals, in this case held that Section 15 of the Severance Tax Statute,

M.C.L.A. 205.315, provides that the severance tax is in lieu of other related property taxes and therefore, "clearly indicates that the severance tax is not in the nature of a business, licensing, privilege, or occupational tax." (Slip op., page 6) In *Market Place v City of Ann Arbor,* the Court of Appeals analyzed a new business license fee imposed by the City of Ann Arbor that is assessed on the basis of the value of property owned by the business subject to the tax. The Court of Appeals held that although that tax is measured by the value of business property and is imposed in lieu of property taxes, because it is a tax imposed upon the performance of an act, the engaging in an occupation, or the enjoyment of a privilege, it is an excise tax, and is not in the nature of a property tax. The Court of Appeals specifically found that ". . . the fact that a tax is measured by the value of property like an *ad valorem* tax, does not mean that the tax is a property tax." (134 Mich App at 577)

In further support of its holding that the City of Ann Arbor tax is not a property tax, the Court of Appeals noted that the subject tax revenue was not treated in the same manner as *ad valorem* property tax revenue, and that the payment of the tax is a condition of the exercise of the privilege involved. Similarly, the Oil and Gas severance tax revenue is not treated in the same manner as property tax revenue, and the severance tax statute specifically provides a mechanism for the withdrawal of the privilege of engaging in the business of producing oil or gas if the tax is not paid (MCLA 205.310).

4. Because the Court of Appeals' decision in *Brown v Shell* conflicts with its decision in *The Market Place v City of Ann Arbor,* Plaintiffs-Appellants cite this conflict as addi-

tional grounds for this Court to grant their Application for Leave to Appeal, pursuant to GCR 1963, 853.1(3).

Respectfully submitted,

THOMPSON, ZIRNHELT, BOWRON, SENGER & ROSI, P.C.

By: /s/ Philip R. Rosi (P-31915)
John N. Seaman, Jr. (P-26274)

Attorneys for Plaintiffs-Appellants
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Telephone 616/946-8630

Dated: October 5, 1984

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

Supreme Court No. 73097
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

PROOF OF SERVICE

STATE OF MICHIGAN)
County of Grand Traverse) SS

The undersigned certifies that a copy of the foregoing instrument was served upon the attorneys of record of all parties* to the above cause by enclosing same in an envelope bearing return address, addressed to such attorney at their business address as disclosed by the pleadings of record herein, with postage fully prepaid and by depositing same in a U.S. Post Office mail box in Traverse City, Michigan.

/s/ Esther L. Cooper

Subscribed and sworn to before me this 5th day of Oct. 1984.

/s/ Lynn M. Sparks, *Notary Public*
Grand Traverse County, Michigan
My Commission Expires: 1/24/88

* Webb A. Smith, Esq.
Dale Rhoades, Esq.

Second Supplement to Application for Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a
Delaware Corporation,
Defendant-Appellee.

Supreme Court No. 73097
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

SUPPLEMENT TO PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

PROOF OF SERVICE

THOMPSON, ZIRNHELT, BOWRON,
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Second Supplement to Application for Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs.

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

Supreme Court No. 73097
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

SUPPLEMENT TO PLAINTIFFS-APPELLANTS' APPLICATION FOR LEAVE TO APPEAL

Albert K. Brown, et al, Plaintiffs-Appellants, as a Supplement to their Application for Leave to Appeal dated November 23, 1983, state as follows:

Plaintiffs' counsel became aware today, March 29, 1985, of a Decision and Order of Determination dated March 17, 1982, by the Michigan Department of Treasury, a copy of which is attached hereto. That Decision and Order of Determination is in conflict with the Court of Appeals' holding in this case, and further supports plaintiffs' Application for Leave to Appeal, since a resolution of this conflict is of major significance to this State's Jurisprudence (MCR 7.302(B)(3)).

The above-mentioned Decision and Order held that in addition to the lessor therein being exempt as an instrumentality of the Federal Government, said lessor was exempt in any event since the Michigan Severance Tax, *as amended*, "does not specifically impose tax on . . . a lessor." This holding conflicts with defendant's position that the 1965

amendment to the Severance Tax Statute made lessors subject to the tax.

Respectively submitted,

THOMPSON, ZIRNHELT, BOWRON, & ROSI, P.C.
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Dated: March 29, 1985

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

-VS-

SHELL OIL COMPANY, a Delaware Corporation,
Defendant-Appellee.

Supreme Court No. 73097
Court of Appeals No. 63011
Lower Court No. 81-8858-CK

PROOF OF SERVICE

STATE OF MICHIGAN)
County of Grand Traverse) SS

The undersigned certifies that a copy of the foregoing instrument was served upon the attorneys of record of all parties to the above cause by enclosing same in an envelope bearing return address, addressed to such attorney at their business address as disclosed by the pleadings of record herein, with postage fully prepaid and by depositing same in a U.S. Post Office mail box in Traverse City, Michigan.

/s/ Esther L. Cooper

Subscribed and sworn to before me this 29th day of March 1985.

/s/ Barbara Ann Mello, *Notary Public*
Grand Traverse County, Michigan
My Commission Expires: 3/4/89

C-91

Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs

SHELL OIL COMPANY, a Delaware Corporation
Defendants-Appellees.

SC: 73097

COA: 63011

LC: 81-8858-CK

NOTICE OF HEARING

APPELLANTS' APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

BRIEF IN SUPPORT OF APPELLANTS' APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

PROOF OF SERVICE

THOMPSON, ZIRNHELT,
BOWRON & ROSI, P.C.
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Dated: February 3, 1986

C-92

Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs

SHELL OIL COMPANY, a Delaware Corporation
Defendants-Appellees.

SC: 73097

COA: 63011

LC: 81-8858-CK

NOTICE OF HEARING

TO:

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PLEASE TAKE NOTICE that Albert K. Brown, et al's Application for Reconsideration of Denial of Leave to Appeal dated February 3, 1986, will be brought on for hearing before the Supreme Court on Tuesday, March 4, 1986.

THOMPSON, ZIRNHELT, BOWRON & ROSI, P.C.
Attorneys for Appellants
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Dated: February 3, 1986

C-93

Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs

SHELL OIL COMPANY, a Delaware Corporation
Defendants-Appellees.

SC: 73097

COA: 63011

LC: 81-8858-CK

APPELLANTS' APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

Pursuant to MCR 7.313(E), Plaimtiffs-Appellants respectfully ask this Court to reconsider its January 15, 1986, denial of their Application for Leave to Appeal from a decision of the Court of Appeals, because the Court of Appeals' determination of the nature and legal incidence of the Michigan Severance Tax is clearly wrong, particularly when compared to conflicting decisions of the Supreme Court and the Court of Appeals issued while the Application was pending.

If the Court of Appeals' decision stands, a large number of the people of this state will bear the burden of a tax the legislature never intended them to carry.

THOMPSON, ZIRNHELT, BOWRON & ROSI, P.C.
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Dated: February 3, 1986

C-94

Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL.,
Plaintiffs-Appellants,

vs

SHELL OIL COMPANY, a Delaware Corporation
Defendants-Appellees.

SC: 73097

COA: 63011

LC: 81-8858-CK

BRIEF IN SUPPORT OF APPELLANTS' APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

THOMPSON, ZIRNHELT, BOWRON & ROSI, P.C.
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Dated: February 3, 1986

Application for Reconsideration of Denial of Leave to Appeal

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Application for Reconsideration of Denial of Leave to Appeal

STATE OF MICHIGAN
IN THE SUPREME COURT

ALBERT K. BROWN, ET AL,
Plaintiffs-Appellants,

vs

SHELL OIL COMPANY, a Delaware Corporation
Defendant-Appellee.

SC: 73097
COA: 63011
LC: 81-8858-CK

BRIEF IN SUPPORT OF APPELLANTS' APPLICATION FOR RECONSIDERATION OF DENIAL OF LEAVE TO APPEAL

Plaintiffs-Appellants respectfully ask this Court to reconsider its denial of their Application for Leave to Appeal because the Court of Appeals' determination of the nature and legal incidence of the Severance Tax is clearly wrong.

If the Court of Appeals' decision stands, a large number of the people of this state will bear the burden of a tax the legislature never intended them to carry.

STATEMENT OF FACTS

Plaintiffs are individuals, landowners who gave oil and gas leases to Shell Oil Company. Shell passes on to plaintiff royalty owners a portion of the tax imposed on Shell under the provisions of Michigan's oil and gas Severance Tax. MCLA 205.301, et seq.; MSA 7.351 et seq. The title describes the statute as:

> "An act levying a *specific* tax to be known as the Severance Tax *upon all producers engaged in the business* of severing oil and gas from the soil . . ." (emphasis supplied)

The enactment section of the statute, Section 1, provides that:

> "There is hereby levied *upon each producer engaged in the business* of severing from the soil, oil or gas, a *specific* tax to be known as the Severance Tax." (emphasis supplied)

The Severance Tax contains no provision authorizing Shell to pass the tax on to royalty owners. Plaintiffs have challenged Shell's practice. At issue is the clarification of ambiguities in the Tax Act and whether or not as a *matter of law* Plaintiffs are taxpayers within the Scope of the Act.

The Circuit Court granted Shell summary judgment, ruling that because plaintiffs are lessors under oil and gas leases, *as a matter of law* they are "producers engaged in the business". The Court of Appeals then went on to affirm the trial court's grant of Summary Judgment, finding "that the language of the severance tax act includes plaintiffs as a matter of law as producers who must pay their share of the tax . . ." The Court of Appeals confirmed that plaintiffs were not producers "actually engaged in the business." Nonetheless, it affirmed Summary Judgment holding: "The plaintiffs did not raise a factual issue by alleging that they were not engaged in the business of severing oil and gas from the soil."

Recent decisions of this Court and the Court of Appeals demonstrate clearly that:

> (a) taxes imposed on a business activity are specific privilege taxes on a limited class of taxpayers "engaged in the business" and one who is not so engaged is not liable for that tax [*Market Place* v *Ann Arbor*, 134 Mich App 567 (1984) and *Detroit Hilton* v *The Department of Treasury*, 422 Mich 422 (1985)]

and,

(b) royalty owners are not engaged in the business of severing oil and gas from the soil [*Mobil Oil* v *Department of Treasury* 422 Mich 473 (1985)]

I. ARGUMENT

THE COURT OF APPEALS' CONCLUSION THAT THE TAX IS NOT IN THE NATURE OF A BUSINESS, LICENSING, PRIVILEGE, OR OCCUPATIONAL TAX VIOLATED STANDARDS OF STATUTORY CONSTRUCTION MANDATED IN *MARKET PLACE* v *CITY OF ANN ARBOR* AND *DETROIT HILTON* v *DEPARTMENT OF TREASURY*.

Even though both plaintiffs and Shell treated the Severance Tax as a privilege tax on a business activity, the Court of Appeals determined that the Severance Tax was *not* in the nature of a business, licensing, privilege, or occupational tax and, hence, by implication, in the nature of a property tax.

The Severance Tax is a "specific tax". A specific tax may not be a property tax: *C. F. Smith Co.* v *Fitzgerald*, 270 Mich 659 at 672, citing *Pingree* v *Auditor General*, 120 Mich 95.

The Court of Appeals' conclusion relied heavily upon the "in lieu of other taxes" provision of Section 15 of the tax statute, a provision unchanged since the statute was first enacted in 1929:

> "Moreover, because the severance tax is *in lieu of other related property taxes*[1], it is assessable against royalty holders as well as lessees who are actually engaged in the business of severing the oil and gas from the soil.

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[1] The Court misstated the trust of Section 15 which reads, in part:

Sec. 15. "The severance tax herein provided for shall be in lieu of all other taxes, state or local, upon the oil or gas, the property rights attached thereto or inherent therein, or the values created thereby; . . ." MCLA 205.315; MSA 7.365

> Section 15, *supra*, clearly indicates that the severance tax is not in the nature of a business, licensing, privilege, or occupational tax." (emphasis supplied) 128 Mich App at 119

The Court's reliance on that language violates the standards set out by this Court in *Dooley* v *City of Detroit* 370 Mich 194 (1963) and repeated by the Court of Appeals in *Market Place:*

> [1.] "Taxes fall naturally into 3 classes, namely, capitation or poll taxes, taxes on property, and excises." (*Dooley* at page 205)
>
> [2.] " . . . [A]n excise tax is any tax which does not fall within the classification of a poll tax or a property tax . . ." (*Dooley* at page 205)
>
> [3.] "An excise is a tax imposed upon the performance of an act, the engaging in an occupation, or the enjoyment of a privilege." (*Dooley* at page 206, citing 26 RCL, Taxation §209, at page 236)

The Court of Appeals in *Market Place* further stated:

> [4.] " . . . [T]he fact that a tax is measured by the value of property, like an ad valorem tax, does not mean that the tax is a property tax." (*Market Place* at page 577)
>
> [5.] [Although the tax] " . . . in question here is, in part, measured upon the value of business property and is imposed in a sense *in lieu of property taxes*, we find the (tax) to be an excise tax . . ." (emphasis supplied) (*Market Place* at page 577)
>
> [6.] " . . . (A) state tax imposed upon motor vehicles using that state's highways was not a property tax although the tax was measured by the value of each

automobile and was assessed *in lieu of all other taxes* on those vehicles." (emphasis supplied) [*Market Place* at page 577-8, citing *Storaasli* v *Minnesota*, 283 U.S. 57 (1931)]

[7.] As distinct from a property tax, "A privilege tax, . . . is imposed upon the right to exercise a privilege, and *its payment is invariably made a condition precedent to the exercise of the privilege involved.*" (emphasis supplied) (*Market Place* at page 578, citing *Ingels* v *Riley*, 5 Cal 2d 154; 53 P2d 939 (1936)

"We find the (tax) to be an excise Tax because it is primarily imposed on the privilege of operating a new business . . ." (*Market Place* at page 579)

The Court of Appeals' absolutist reasoning that because the tax is "in lieu of" other taxes it necessarily is "not in the nature of a business, licensing, privilege or occupational tax," is in irreconcilable conflict with the analysis in *Market Place*.

Everything about the Severance Tax statute points to it being a privilege tax. The statute states in its title and body that it is a *specific tax* on producers engaged in the business and provides sanctions for non-payment. Section 10 of the Act allows the Attorney General to obtain an Injunction against those who fail to pay the tax, prohibiting them from further engaging in the oil and gas business:[2]

"If a tax is imposed directly by the legislature without assessment, and its sum is measured by the amount of

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[2] Injunction. Sec. 10. Upon a bill being filed under the direction of the attorney general in the circuit court for the county of Ingham, that court shall have power to restrain by injunction, any corporation, association or person who has failed to comply with any of the provisions of the act and in the same manner to restrain any corporation, association or person from continuing to produce oil or gas while delinquent in the filing of any report or the paying of any tax, penalty, or cost required under the provisions of this act. (MC§205.310; CL '29, §3613;MSA §7.360)

business done or the extent to which the conferred privileges have been enjoyed or exercised by the taxpayer, irrespective of the nature or value of the taxpayer's assets, it is regarded as an excise. Although an excise or privilege tax, like a property tax, is passed to raise revenue, it is to be distinguished from property taxation in that it is imposed upon the right to exercise a privilege, and *its payment is made a condition to the exercise of the privilege involved.*" 71 Am Jur 2d *State and Local Taxation*, §29. (emphasis supplied)

Had the Court employed the *Market Place* principles, it would have concluded that the Severance Tax *is* in the nature of a business, licensing, privilege or occupational tax.

(DETROIT HILTON V. TREASURY)

This Court's decision in *Detroit Hilton* v *Treasury*, supra, decided while this application was pending, is wholly inconsistent with the Court of Appeals' decision in this case. This Court concluded that Hilton was not engaged in the business activity being taxed and, therefore, not subject to the tax. This Court reversed a decision of the Court of Appeals imposing privilege tax liability on Hilton, a landowner-lessor, owner of a hotel building in which its lessee, DHOC, operated a hotel business:

"Before this Court, Hilton argues that it cannot be held liable for these taxes unless it engaged in the activities which produced the tax liability . . . We agree.

"The record demonstrates that during the entire period for which Hilton has been assessed tax liability for the operation of the hotel business by DHOC, Hilton's only relationship was as a landlord . . . *Section 2 of the Sales Tax Act states that sales tax liability is*

incurred by engaging 'in the business of making sales at retail'.[3]

"It is uncontroverted that Hilton engaged in none of the activities described in those statutes, and it is clear that none of the tax obligations described in the statutes apply to mere lessors of real property in which taxable activities might be conducted." (emphasis supplied) 422 Mich at 427, 428.

Plaintiffs in this case are in precisely the same position. They have leased their lands to an oil company giving that company the exclusive right to explore for and extract oil and gas from the leased property. In return, each landowner receives as ordinary rental income, royalties.

Parallel with Section 2 of the Sales Tax, Section 1 of the Severance Tax clearly levies the tax upon one engaged in the specific business activity to which the tax is addressed. The Court of Appeals noted that it is the Lessee (Shell Oil) and not the Royalty Holders (Plaintiffs) that is "actually engaged in the business." The Court acknowledged that the statute contains language limiting the taxpayer class:

"§1 still retains the phrase qualifying a producer as one 'engaged in the business of severing from the soil . . .' " (128 Mich App at 116).

Nonetheless, the Court of Appeals ignored that language and concluded that Plaintiffs are subjected to liability imposed upon "producers engaged in the business . . .". By ignoring that limiting language, the Court's decision:

(a) expanded the scope of the taxpayer class beyond that defined in both the Title and Section 1,

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[3] Sec. 2. There is hereby levied upon and there shall be collected from *all persons engaged in the business of making sales at retail*, as hereinbefore defined, an annual tax for the privilege of engaging in such business equal to [4%] of the gross proceeds thereof, plus the penalty and interest when applicable as hereinafter provided, less deductions allowed in sections 4 and 4a. (emphasis added) MSA 7.522; MCLA 205.52

(b) is in direct conflict with established principles of statutory construction,

(c) violates this Court's recognition in *Hilton* of the *legal* necessity to conform to that limiting language, and

(d) establishes a taxpayer class repugnant to both the Title and the enactment clause (Section 1).

Under the Court of Appeals' analysis, one must ignore the Title, ignore Section 1, read through twelve sections of the Act to discover who the taxpayer is, and read through a total of fifteen sections to determine the Nature of the tax. As interpreted by the Court of Appeals, the incidence of the Severance Tax has nothing to do with the business activity of severing the oil or gas from the soil. Not only is that interpretation contrary to the plain language of the Act and its title, the analysis is in irreconcilable conflict with the decisions in *Hilton* and *Market Place*. The Severance Tax is an excise tax on the privilege of engaging in the business.

II.

MOBIL OIL v _TREASURY_ ESTABLISHES THAT, UNDER THE ECONOMIC REALITIES OF OIL AND GAS TRANSACTIONS, LESSORS-LANDOWNERS ARE NEITHER "IN THE BUSINESS" NOR DO THEY RECEIVE PROPERTY, SUCH AS WOULD SUBJECT THEM TO TAX LIABILITY, _REGARDLESS OF WHETHER THE SEVERANCE TAX IS INTERPRETED TO BE A PRIVILEGE OR A PROPERTY TAX._

The Court of Appeals' decision is in direct conflict with this Court's recent opinion in *Mobil Oil Corporation* v *Department of Treasury*, 422 Mich 473 (1985). The conflict with *Mobil Oil* is of particular concern because Plaintiffs'

Application for Reconsideration of Denial of Leave to Appeal

Application for Leave to Appeal was held in abeyance by this Court pending its decision in *Mobil Oil*.

The Court of Appeals' decision reflects a misconception of the relationship which in fact exists between a lessor and lessee under an oil and gas lease. In *Mobil Oil*, this Court held that the Single Business Tax was a value added tax (also a tax on business activity) imposed upon the entrepreneur. This Court concluded that royalty owners are *not* entrepreneurs obligated to pay a pro-rata share of the single business tax:

> "The landowner-lessor, in oil and gas leases of this type, is *not involved in production at all, but is merely a passive recipient of income*. It is the operator-lessee who adds labor, entrepreneurial initiative, and capital (drilling equipment, etc.) to the land in order to extract the raw material, oil or gas. The operator-lessee, not the landowner-lessor, combines inputs and adds value to the economy. Therefore, *it is the operator-lessee who is the entrepreneur in oil and gas leases* and who 'uses' the ⅛ 'royalty share' of production according to VAT theory. This means that it is the operator-lessee who is the proper VAT taxpayer on this ⅛ of production." (emphasis supplied).

It bears repeating that the title of the Act describes the statute as:

> "An act levying a *specific* tax to be known as the Severance Tax upon all *producers engaged in the business* of severing oil and gas from the soil . . ." (emphasis supplied)

In complete harmony with the title, Section 1 levies the Tax:

> "There is hereby levied *upon each producer engaged in the business* of severing from the soil, oil or gas, a *specific* tax to be known as the Severance Tax." (emphasis supplied).

Section 12(2) defines "producer" as meaning:

> "A person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil at the time of its production or severance."

Plaintiffs' position has always been that they are not "producers" and that they are not "engaged in the business". They are merely lessors of lands whose tenant, Shell Oil Company, engages in the oil and gas business. As rent from their tenant, Plaintiffs are paid "royalties" for the privilege of extracting minerals from their lands.

The Circuit Court granted Shell summary judgment, ruling that because Plaintiffs are lessors under oil and gas leases, *as a matter of law* they are "producers engaged in the business". The Court of Appeals then went on to affirm the trial court's grant of Summary Judgment, finding that the Plaintiffs are "producers" who *as a matter of law* must pay a share of the tax.

Those conclusions run totally contrary to this Court's decision in *Mobil*. As was referenced above, this Court clearly determined that the typical royalty owner is "merely a passive recipient of income" and is *not* engaged in the business of severing oil and gas.

The Severance Tax is a privilege, business or occupational tax. The *Mobil Oil* decision clearly establishes that Plaintiffs should not be obligated to pay a share of that tax because they are not engaged in the business being taxed.

Even if the Severance Tax is a property tax, the Court of Appeals' decision still conflicts with Mobil Oil. The Court of Appeals' decision implies, erroneously, that the Severance Tax is a Property Tax. The Court of Appeals also held that royalty owners are subject to the tax. Therefore, the Court's

decision must mean that royalty owners have a property interest in the production from the wells.

This Court's decision in *Mobil Oil* clearly demonstrates that royalty owners do not have a property interest in that production. Footnote 2 at page 480 of the *Mobil Oil* decision poses the question squarely:

> "This mixture of elements is at the root of the difficulty in characterizing the ⅛ of gross production in the lessor is entitled to receive under the oil and gas 'lease'. *Is it a payment out of the lessee's property, akin to rent, or a return to the lessor of his property?* Is the landowner paying the operator ⅞ of production for the service of extracting the landowner's ⅛ of the oil and gas, or is the operator paying the landowner ⅛ of production for use of the surface of the property and the acquisition of ⅞ of the oil or gas?" (emphasis supplied).

The latter was found to be true by this Court in *Mobil Oil*. This Court clearly *rejected* Mobil Oil's contention that the royalty owner "is the continuous and uninterrupted owner of the royalty oil and gas, both in the ground and when it is extracted" and its contention that it is the royalty owner "who added value to this portion of production from the leased property." This Court determined that a royalty owner "is merely a passive recipient of income," receiving payments akin to rent.

The Court of Appeals' decision in this case and the *Mobil Oil* decision simply cannot be squared. The Court of Appeals (ignoring the clear language of the statute) held that the Severance Tax is not in the nature of a business, licensing, privilege, or occupational tax. The Court of Appeals then determined that all royalty owners are as a matter of law obligated to pay "their share of the tax". Implicit in that decision must be a determination that a royalty owner is the owner of a *property* interest that can be the subject of a *property* tax. In *Mobil*, this Court determined that royalty

owners are *not* the recipients of a "share" of production, but receive only income in the nature of rent. This income or rent simply cannot be the subject of a property tax. A tax on income is an excise tax, and *not* a property tax. *Dooley* v *City of Detroit*, 370 Mich 194 (1963).

The cases are in irreconcilable conflict. How can the Plaintiff royalty owners be subject to a tax that the Court of Appeals (improperly) says is a property tax when this Court in *Mobil Oil* says that the Plaintiff royalty owners do not receive any property from the Defendant producer? How can the Plaintiff royalty owners be subject to a privilege tax upon a business or occupation when this Court in *Mobil Oil* says that Plaintiffs are not involved in that business or occupation?

It makes no difference whether the Severance Tax is deemed a property tax or a privilege tax. The royalty owners are not subject to it under either interpretation.

This Court quite properly and appropriately held its determination of Plaintiffs' Application for Leave to Appeal in abeyance pending its decision in *Mobil Oil*. There is an important and significant relationship between those cases. The conflict between this Court's decision in *Mobil Oil* and the Court of Appeals' decision in this case demonstrates that the decision by the Court of Appeals was in error and Plaintiffs' Application for Leave to Appeal should have been granted. Nevertheless, that Application was denied.

The relevancy of *Hilton*, *Market Place* and *Mobil Oil* to the just and equitable resolution of this case cannot be reasonably questioned. All four cases address tax statutes which by their terms place tax liability upon business activity. Aside from the grave injustice done to the Plaintiffs in this case, the Michigan Bench and Bar are now presented with substantial and important inconsistencies which should not be left unresolved.

This Court's decisions in *Hilton* and *Mobil Oil* and the Court of Appeals decision in *Market Place* demonstrate that the Court of Appeals was wrong. A different result might well have been reached by the Trial Court or the Court of Appeals, had the *Mobil Oil*, *Hilton* or *Market Place* decisions been available. Plaintiffs respectfully request that this Court grant them Leave to Appeal or, alternatively, remand these proceedings to the trial court for further review in light of the decisions in *Hilton*, *Market Place* and *Mobil Oil*.

CONSTITUTIONAL ISSUES

Over and above the conflicts with *Hilton*, *Market Place* and *Mobil Oil*, the decisions in this case by the Circuit Court and the Court of Appeals give rise to constitutional issues which need to be resolved.[4]

It has been urged that because this proceeding involves private litigants, Constitutional inquiry is not appropriate, and if it were, Plaintifs should have raised the issues at the outset before the Circuit court. Although such principles usually apply, because of the unusual factual circumstances of this case, Plaintiffs urge that those principles should not foreclose further judicial inquiry by this Court into the Constitutional concerns that now arise.

Defendant Shell passes on to plaintiffs a portion of a tax levied upon Shell. *As construed by the Court of Appeals*, the Severance Tax statute is subject to constitutional attack. Under Plaintiffs' interpretation, on its face the statute is *not*

[4] It should also be noted in this regard that the theory adopted by the Court of Appeals was never raised in any pleading or argument by either party to this case. Even the Defendant did not urge that the Severance Tax was *not* an excise tax. It is for this reason that not all of the Constitutional arguments addressed in Plaintiffs' Application for Leave to Appeal were argued in the Courts below. The statute is *not* subject to Constitutional attack under Plaintiffs' interpretation.

subject to such attack. If the Court of Appeals' ruling is permitted to stand, based as it is upon a Constitutionally improper interpretation of the statute, Plaintiffs may be barred by principles of *res judicata* from challenging Shell's action of passing on to them a portion of the tax. (No provision is contained in the Severance Tax equivalent to that in the Sales Tax allowing the tax to be passed on.)

The Court of Appeals found that Plaintiffs are not "actually engaged in the business," 128 Mich App at 119; nonetheless, the Circuit Court and the Court of Appeals have concluded *as a matter of law* that Plaintiffs are in the class of taxpayers who are actually engaged in that business. The interpretation by those courts places Plaintiffs within the class of taxpayers of "producers engaged in the business" when in fact they are neither "producers" nor are they "engaged in the business." Such an interpretation clearly violates the Due Process Clauses of both the 14th Amendment to the United States Constitution and Article I, Section 17 of the Michigan Constitution, 1963, as it is arbitrary and capricious to declare that to be a fact which is not a fact solely to place a citizen into a class of taxpayers, when in actuality, he is not within that class.[5] (*Hoeper* v *Tax Com-*

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[5] Shell made the same Constitutional argument in its brief filed more than forty years ago in *Ohio Oil Co., et al* v *Wright* (infra), a copy of which brief has been made a portion of the Record herein:

> "The Act arbitrarily classifies as being in the business of producing oil persons who are not in that business, and so deprives them of their property without due process of law, contrary to Sections 2 and 13 of Article II of the Constitution of Illinois, and to the 14th Amendment to the Constitution of the United States.
>
> "No other jurisdiction has held that royalty owners are engaged in the business of producing oil."

Although Shell cited several cases to support that early position that royalty owners were not engaged in the business of producing oil, when in this case Shell took the opposite view, it cited no support for that new position. The Illinois Supreme Court, relying upon several of the same cases cited by this Court in *Mobil Oil* in determining the actual relationship between lessors and lessees, adopted Shell's position:

(footnote 5 continued on next page)

missioner, 284 U.S. 206-215 (1931); 76 L Ed 248, 251; *Michigan Public Utilities Commission* v *Duke*, 266 U.S. 570, 577 (1924); 69 L Ed 445, 450; *Frost* v *Railroad Commission*, 271 U.S. 583, 593 (1926); 70 L Ed 1101, 1104; *Standard Oil Company* v *Police Jury*, 140 La 42, 72 So 802; *Grubaugh* v *City of St. Johns*, 384 Mich 165, 170 (1970); *Lockwood* v *Commissioner of Revenue*, 357 Mich 517, 541 (1959)

The interpretation placed on the Statute by the Court of Appeals also violates the Title-Object Clause of the Michigan Constitution of 1963, MCLA Const. Art. IV, §24; and the constitutional requirement of a distinct statement of a tax, MCLA Const. Art. IV, §32,. The Court of Appeals concluded that the 1965 Amendment of the tax statute altered the basic nature of the tax from a privilege tax to one "not in the nature of a privilege, business or occupational tax." Had the legislature in fact had that intention when the Amendment was adopted, the legislature should have clearly expressed that intention, which it did not. The Court of Appeals in *Hildebrand* v *Revco Discount Drug Centers*, 137 Mich App 1, (1984), decided after Plaintiffs'

(footnote 5 continued from previous page)

"It manifestly is not a fact that such royalty owners are in the business of producing oil any more than a stockholder by accepting the dividends from a corporation is in the corporate business, whether the dividends be cash or property in kind . . .

"The Legislature does not have the power by legislation to declare that not to be a fact which everyone knows is a fact (citation omitted), and, by the same reasoning, cannot legislate that to be a fact which everyone knows is not a fact. To make the fact of ownership of oil, alone, the criterion of engaging in business if producing oil so obviously includes persons who may not and cannot be in such business as to render it obnoxious to the Constitution." *Ohio Oil Co, et al.* v *Wright*, 53 NE 2d 966 at 972 (Ill. 1944). See also *Cole* v *Pond Fork Oil & Gas Co.*, 127 W. Va. 762, 35 SE 2d 25 at 29 (1945), reh. den, cert. den. 66 S Ct 147;

"The designation of the persons composing a class may not be arbitrary or capricious, and uniformity may be violated by including those in fact not within the class." *Ohio* v *Wright*, *supra*, at 973

Application to this court, restated the "four judicially recognized purposes behind the single object clause (Art. 4, §24):

> (1) to prevent the Legislature from passing laws not fully understood, (2) to fairly notify the Legislature of a proposed statute's design and purpose, (3) to aid the legislature and the public in understanding that only subjects germane to the title would be included in the legislation, and (4) to curtail "log-rolling" by preventing the bringing into one bill of diverse subjects not expressed in its title." *Hildebrand* at page 6

to conform to Art. IV, §24 of the Constitution, the four purposes must be met and the lower courts' reasonings reveal that they were not.

As to Art. 4, § 32, this Court has mandated:

> "The scope of tax laws may not be extended by implication or forced construction." *Garavaglia* v *Mich. Dept. of Revenue*, 338 Mich 467 at 471 (1954)

The Circuit Court's and Court of Appeals' disregard of the statutory, qualifying words "engaged in the business" can only be characterized as "forced construction" and should not be permitted to stand unchallenged. See also *Standard Oil Co.* v *Michigan* 283 Mich 85 (1937), at 88:

> "'In the interpretation of statutes levying taxes, it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.' *Gould v Gould*, 245 U.S. 151 (38 Sup. Ct. 53)"

This Court in *Standard Oil, supra*, cited *In re Dodge Brothers*, 241 Mich 665 (1928) for the same principle relied on by this Court in *Hilton* to be controlling:

> "Tax exactions, property or excise, must rest upon legislative enactment, and collecting officers can only act within express authority conferred by law. Tax collectors must be able to point to such express authority so that it may be read when it is questioned in court. The scope of tax laws may not be extended by implication or forced construction. Such laws may be made plain, and the language thereof, if dubious, is not resolved against the taxpayer."

The interpretation of the Severance Tax Act by the Court of Appeals exposes that statute to Constitutional attack demonstrating that the Court of Appeals' decision (a) was erroneous and (b) should be reviewed by this Court.

CONCLUSION AND RELIEF REQUESTED

In sum, the Severance Tax must be either a privilege tax on an occupation or a property tax. If the Severance Tax is a privilege tax, Plaintiff royalty owners are not engaged in the business occupation being taxed. If the Severance Tax is a property tax (which it is not), Plaintiff royalty owners do not have or receive a property interest that could be subject to the tax. Plaintiff royalty owners are simply not subject to the Severance Tax. The Court of Appeals' affirmation of the Circuit Court's granting of Summary Judgment to Shell was clearly in error.

Knowing that this Court is extremely busy, Plaintiffs nevertheless respectfully urge that this case deserves further consideration. The Court of Appeals' decision will not hold up to scrutiny and should not be allowed to stand without review. Plaintiffs therefore implore this Court to reconsider its denial of their Application, confident that by doing so the Court will feel compelled to either Grant Leave to Appeal or, alternatively remand these proceedings for further review in light of *Mobil Oil*, *Hilton* and *Market Place*.

Respectfully submitted,

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APPENDIX D

MICHIGAN OIL AND GAS SEVERANCE TAX ACT

(MCLA 205.301 *et seq.*; MSA 7.351 *et seq.*)

APPENDIX D
MICHIGAN OIL AND GAS SEVERANCE TAX ACT

P.A. 1929, No. 48, Eff. Aug. 28

AN ACT levying a specific tax to be known as the severance tax upon all producers engaged in the business of severing oil and gas from the soil; prescribing the method of collecting the tax; requiring all producers of such products or purchasers thereof to make reports; to provide penalties; to provide exemptions and refunds; to prescribe the disposition of the funds so collected; and to exempt those paying such specific tax from certain other taxes. Amended by P.A. 1965, No. 299, Imd. Eff. July 22.

The People of the State of Michigan enact:

205.301. Severance tax on oil or gas

Sec. 1. There is hereby levied upon each producer engaged in the business of severing from the soil, oil or gas, a specific tax to be known as the severance tax.

205.302. Monthly reports; contents, form

Sec. 2. (1) Every corporation, association, person, common carrier, pipe line company or common purchaser, who shall receive or purchase or transport any such oil or gas, shall make a report on or before the twenty-fifth day of each month in the form and manner required by the department of revenue, showing the total amount of such oil and gas received, purchased, stored or transported during the preceding month, and the actual market value thereof at the time it is received, purchased, stored or transported, and such other information as may be required by the department.

(2) Each producer, when requested by the department, shall file such report in the form and manner required by the department.

205.303. Tax rate; computation; payor; withholding and payment

Sec. 3. (1) Except as provided in subsection (2), the severance tax required to be paid by each producer at the time of rendering each monthly report, or by a pipeline company, common carrier, or common purchaser, for and on behalf of a producer, shall be in the amount of 5% of the gross cash market value of the total production of gas or 6.6% of the gross cash market value of the total production of oil during the preceding monthly period, exclusive of the production or proceeds from the production attributable to the state, the government of the United States, or a political subdivision of the state or government of the United States. The value of all production shall be computed as of the time when and at the place where the production was severed or taken from the soil immediately after the severance. Except as otherwise provided in this section, the payment of the severance tax shall be required of each producer. If the production is sold or delivered to a pipeline company and is transported by the pipeline company through lines connected with the oil or gas well of the owner, or of a common purchaser, the pipeline company, or common purchaser shall receive and accept all the oil and gas, subject to a lien as prescribed in section 8[1] and the pipeline company shall withhold out of the proceeds or price to be paid for the products severed, the proportionate parts of the tax due by the respective owners of the oil and gas at the time of severance and, at the time required for the filing of the monthly reports required in section 2[2], shall pay to the department of revenue all the tax money so collected or withheld. Each pipeline company, common carrier, or common purchaser shall deduct from the purchase price to a producer from whom it may receive the oil or gas the amount of the severance tax levied in this section before making the payment. If under the terms of a contract the

[1] Section 205.308.

[2] Section 205.302.

pipeline company, common carrier, or common purchaser shall be required to reimburse a producer of oil or gas for the amount of the severance tax or a part thereof, the tax reimbursement shall not be considered a part of the gross cash market value of the total production of the oil or gas.

(2) The severance tax required to be paid by each producer at the time of rendering each monthly report, or by a pipeline company, common carrier, or common purchaser, for and on behalf of a producer, on stripper well crude oil, as defined in section 8 of the emergency petroleum allocation act of 1973, 15 U.S.C. 757 and on crude oil from marginal properties as defined in part 212, subpart D, of chapter II of title 10 of the code of federal regulations 10 CFR 212.72 to 212.77, shall be in the amount of 4% of the gross cash market value of the total production of the oil, during the preceding monthly period, exclusive of the production or proceeds from the production attributable to the state, the government of the United States, or a political subdivision of the state or government of the United States. The value of all production shall be computed as of the time when and at the place where the production was severed or taken from the soil immediately after the severance.

205.304. Production record, keeping, open to inspection; penalty

Sec. 4. Each corporation, association or person mentioned and included in sections 1 and 2 of this act[1] shall make, keep and preserve a full and complete record of all such oil produced in this state during the time so engaged in its production, and said record shall be open at all times to the inspection of the Michigan tax commission. Any corporation, association or person failing to comply with this requirement shall be subject to a penalty of not less than 500 and not more than 1,500 dollars payable to the state of Michigan, and such penalty shall accrue for each 20 days of failure to comply with this section with reference to each seperate oil or gas well.

[1]Sections 205.301 and 205.302.

205.305. Report, contents

Sec. 5. In each report required to be made by this act, such corporation, association or person making the same shall show in detail the disposition made of any such oil or gas. Said report shall show to whom any such oil or gas was sold or delivered to each, and shall show the name and location of the person, refinery, pipe line establishment, plant, factory, railroad, institution or place to which or to whom delivery was made.

205.306. Administration; rules; deficiency, interest, or penalty; limitations

Sec. 6. (1) The tax imposed by this act shall be administered by the revenue commissioner of the department of treasury, under Act No. 122 of the Public Acts of 1941, as amended, being sections 205.1 to 205.19 of the Michigan Compiled Laws, and this act. In case of conflict between Act No. 122 of the Public Acts of 1941, as amended, and this act, the provisions of this act shall prevail.

(2) Rules shall be promulgated under this act pursuant to Act No. 306 of the Public Acts of 1969, as amended, being sections 24.201 to 24.315 of the Michigan Compiled Laws.

(3) A deficiency, interest, or penalty shall not be assessed after the expiration of 4 years after the date set for the filing of the required return or the date the return was filed, whichever is later. The taxpayer shall not claim refund of any amount paid to the department after the expiration of 4 years after the date of the payment. A taxpayer shall not assign a claim against the state to any other person. If a person subject to tax under this act fraudulently conceals any liability for the tax or a part of the tax, the commissioner, upon discovery of the fraud and within 2 years thereafter, shall proceed to assess the tax with penalties and interest as provided, computed from the date on which the tax liability originally accrued and the tax, penalties, and interest shall become due and payable after notice and hearing as provided.

(4) The running of the statute of limitations shall be suspended for:

(a) The period pending a final determination of tax after issuance of a notice of intent.

(b) A period which the taxpayer and the commissioner consent to in writing.

Amended by P.A.1980, No. 166, § 1, Eff. Sept. 17.

205.307 to 205.309. Repealed by P.A.1980, No. 166, § 2, Eff. Sept. 17

205.310. Injunction

Sec. 10. Upon a bill being filed under the direction of the attorney general in the circuit court for the county of Ingham, that court shall have power to restrain by injunction, any corporation, association or person who has failed to comply with any of the provisions of this act and in the same manner to restrain any corporation, association or person from continuing to produce oil or gas while delinquent in the filing of any report or the paying of any tax, penalty or cost required under the provisions of this act.

205.311. Oil defined

Sec. 11. The word "oil" as used in this law means petroleum oil, mineral oil or other oil taken from the earth.

205.312. Persons, producers; defined

Sec. 12. (1) "Person" as used in this act shall include any person, firm, concern, receiver, receivers, trustee, executor, administrator, agent, institution, association, partnership, company, corporations, and persons acting under declarations of trust.

(2) "Producer" as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds from the sale of, gas or oil as of the time of its production or severance.

205.313. Receipt, contents

Sec. 13. Any corporation, association or person paying any tax, penalty or cost under the provisions of this act, to the state tax commission shall be entitled to a receipt for the same, showing the time of payment and the purpose for which paid.

205.314. Severance taxes to accompany report; general fund

Sec. 14. (1) All taxes shall accompany the report provided for in section 2.[1] Except as provided in subsection (2), all taxes, penalties, or costs paid to the state tax commission under this act shall be paid into the state treasury and shall be credited to the general fund of the state where they shall be available for any purpose for any purpose for which the general fund is made available by law.

(2) The revenue collected under subsection (1) in excess of $16,000,000.00, shall be deposited in the general fund and shall be allocated for the payment of credits for heating fuel costs provided under section 527a of Act No. 281 of the Public Acts of 1967, being section 206.527a of the Michigan Compiled Laws, for the fiscal year ending September 30, 1980 only.

205.315. Severance tax in lieu of other taxes; exceptions

Sec. 15. The severance tax herein provided for shall be in lieu of all other taxes, state or local, upon the oil or gas, the property rights attached thereto or inherent therein, or the values created thereby; upon all leases or the rights to develop and operate any lands of this state for oil or gas, the values created thereby and the property rights attached to or inherent therein: Provided, however, Nothing herein contained shall in anywise exempt the machinery, appliances, pipe lines, tanks and other equipment used in the development or operation of said leases, or used to transmit or transport the said oil or gas: And provided, fur-

[1]Section 205.302.

ther, That nothing herein contained shall in anywise relieve any corporation or association from the payment of any franchise or privilege taxes required by the provisions of the state corporation laws.

205.316. Repealed by P.A.1980, No. 166, § 2, Eff. Sept. 17

205.317. Information as to production; availability, conditions

Sec. 17. The department of revenue may provide information to any person as to the quantities of oil or gas purchased or reported when the department is satisfied that the information will be used for public or petroleum industry educational or research purposes.